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Nos. 93-1612, 93-1613



IN THE

# Supreme Court of the United States

OCTOBER TERM, 1994

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NATIONSBANK OF NORTH CAROLINA, N.A. AND
NATIONSBANC SECURITIES, INC.,
*Petitioners,*

v.

VARIABLE ANNUITY LIFE INSURANCE CO.,
*Respondents.*

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**On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit**

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## BRIEF OF PETITIONERS NATIONSBANK OF NORTH CAROLINA, N.A. AND NATIONSBANK SECURITIES, INC.

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ROBERT M. KURUCZA
STEVEN S. ROSENTHAL
*Counsel of Record*
ROBERT G. BALLEN
LESLIE J. CLOUTIER
MORRISON & FOERSTER
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006
(202) 887-1500

*Counsel for NationsBank of North Carolina, N.A. and NationsBanc Securities, Inc.*

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## QUESTIONS PRESENTED

1. Whether the Fifth Circuit misapplied the *Chevron* standard when it engaged in a *de novo* analysis and failed to defer to the Comptroller's reasonable construction of 12 U.S.C. §§ 24(7) and 92 and his determination that annuities do not constitute "insurance" for purposes of 12 U.S.C. § 92.

2. Whether 12 U.S.C. § 92, which provides that, "in addition to" their other powers, national banks located in places with 5,000 or fewer inhabitants may act as the agent for "any fire, life, or other insurance company," impliedly bars national banks in more populous places from brokering annuities, even though the Comptroller has determined such activity to be part of the "business of banking" or "incidental" thereto under 12 U.S.C. § 24(7).

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## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit (Pet. App. 1a-17a)[1] is reported at 998 F.2d 1295. The opinion of the United States Court of

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[1] On June 27, 1994, this Court granted petitioners' motion to dispense with the requirement of a joint appendix, since relevant portions of the record already were reproduced in the appendix to NationsBank's certiorari petition. References to that appendix are designated "Pet. App. ___" throughout this brief.

Appeals for the Fifth Circuit denying rehearing and rehearing *en banc*, and the opinion dissenting therefrom (Pet. App. 18a-28a) are reported at 13 F.3d 833. The opinion of the United States District Court for the Southern District of Texas (Pet. App. 29a-34a) is reported at 786 F. Supp. 639. The approval of the Office of the Comptroller of the Currency (the "Comptroller") (Pet. App. 35a-48a), dated March 21, 1990, at issue here, is unreported (the "Comptroller's Approval").[2]

## JURISDICTION

The judgment of the court of appeals was entered on August 26, 1993. Petitions for rehearing and suggestions for rehearing *en banc* were denied on January 13, 1994. Petitions for certiorari were filed on April 13, 1994, and were granted on June 6, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## STATUTORY PROVISIONS INVOLVED

1. 12 U.S.C. § 24 (section 5136 of the Revised Statutes of 1878) provides, in pertinent part:

> Upon duly making and filing articles of association and an organization certificate a national banking association shall become, as from the date of the execution of its organization certificate, a body corporate, and as such, and in the name designated in the organization certificate, it shall have power—

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[2] The Comptroller's Approval, in turn, references (Pet. App. 35a) Interpretive Letter No. 499 of the Chief Counsel of the Comptroller, dated February 12, 1990. *See* OCC Ltr. No. 499, *reprinted in* [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) 83,090 (Feb. 12, 1990) ("Chief Counsel's Letter"). The Chief Counsel's Letter is attached as an appendix hereto. References to that appendix are designated "App. ____" throughout this brief.

* * * *

> Seventh. To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits, by buying and selling exchange, coin and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of title 62 of the Revised Statutes. The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account . . . .

2. 12 U.S.C. § 92 (originally enacted as Act of September 7, 1916, ch. 461, 39 Stat. 753, and amended by Act of October 15, 1982, Pub. L. No. 97-320, 403(b), 96 Stat. 1511) provides, in pertinent part:

> In addition to the powers now vested by law in national banking associations organized under the laws of the United States any such association located and doing business in any place the population of which does not exceed five thousand inhabitants, as shown by the last preceding decennial census, may, under such rules and regulations as may be prescribed by the Comptroller of the Currency, act as the agent for any fire, life, or other insurance company authorized by the authorities of the State in which said bank is located to do business in said State, by soliciting and selling insurance and collecting premiums on policies issued by such company; and may

> receive for services so rendered such fees or commissions as may be agreed upon between the said association and the insurance company for which it may act as agent . . . .

## STATEMENT OF THE CASE

This case presents a question of substantial importance to national banks—whether they are permitted under federal banking laws to sell as agent (*i.e.*, broker) fixed and variable annuity contracts to their customers. The question has arisen in a challenge to the Comptroller's approval of the request of NationsBank of North Carolina, N.A. ("NationsBank") to have its wholly-owned brokerage operating subsidiary, NationsBanc Securities, Inc. ("NSI"),[3] broker fixed and variable annuity contracts issued by annuity issuers unaffiliated with NationsBank or NSI.

A fixed annuity is a contract in which an issuer agrees, commencing at a specified time (the "maturity date"), to make periodic payments to the purchaser or other beneficiary for the life of the purchaser (or another party, such as the surviving spouse of the purchaser) or for a fixed term, in return for one or more payments made during a "pay-in" period. In a pure fixed annuity, the amount of the periodic payments are specified in the contract or based upon a set interest rate. In effect, a fixed annuity is a debt obligation of the issuer. Most modern fixed annuities, including those at issue here, include a discretionary excess interest feature whereby the issuer has discretion to pay additional amounts beyond the contractually-set minimum payments. *See generally* Pet. App. 35a-36a & n.1.

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[3] Petitioners have undergone a change of name during the course of this case. NationsBank was previously NCNB National Bank of North Carolina and NSI was previously NCNB Securities, Inc. NationsBank Corporation is the parent company of NationsBank. NationsBank Community Development Corporation and NationsBank Housing Fund Investment Corporation are partially owned subsidiaries of NationsBank.

In a variable annuity, the payments are segregated and invested in a pooled investment vehicle selected by the annuity purchaser. The value of a variable annuity contract at the maturity date is dependent upon the performance of the investment pool selected by the purchaser, although there sometimes is a minimum performance return guaranteed under the contract. Upon the maturity date, a variable annuity can provide various payment options, including level, variable, and lump sum payments, or a combination thereof. Pet. App. 35a-36a; *SEC v. Variable Annuity Life Insurance Co.*, 359 U.S. 65, 68-72 & n.13 (1959) ("*SEC v. VALIC*").[4]

Fixed and variable annuities have become popular retail investment vehicles used by an increasing number of individuals to pursue their investment and retirement goals. Annuities, as investment options, compete directly with a broad range of other retail investment products, such as taxable and tax-free mutual funds, certificates of deposit and equity and fixed income securities. Because annuities possess certain tax-deferral characteristics, they can be an especially attractive investment alternative for particular investors. Annuities are widely marketed to the public based upon their tax-deferred investment attributes and not on the basis of any risk-insuring characteristics.

Currently, securities brokerage firms, insurance companies and their agents, insurance brokers, and numerous depository institutions (directly or through subsidiaries and

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[4] Variable annuity contracts are registered under the Investment Company Act of 1940, 15 U.S.C. § 80a-1, *et seq.* ("Investment Company Act"), as a type of investment company, similar in substance to mutual funds. These annuity contracts also must be registered as securities under the Securities Act of 1933, 15 U.S.C. § 77a, *et seq.* ("Securities Act"). *See SEC v. VALIC*, 359 U.S. at 67-68. In addition, at least some fixed annuities also are required to be registered as securities under the Securities Act. This Court has stated that "the term 'security' as defined in the Securities Act is broad enough to include *any* 'annuity' contract." *Ibid.* (footnote omitted) (emphasis added).

affiliates), including federally-chartered thrift institutions, many state-chartered banks and state-chartered thrift institutions, and credit unions, are authorized to sell fixed and variable annuities as investment alternatives. For example, the New York Court of Appeals has recently affirmed the determination of the New York Banking Department that the brokering of annuities by New York state-chartered banks is an "incidental power" of the "business of banking" under New York banking law. *New York State Ass'n of Life Underwriters, Inc. v. New York State Banking Dep't*, 83 N.Y.2d 353, 360, 632 N.E.2d 876, 879 (N.Y. 1994). Accordingly, a substantial number of the depository institutions and other financial services providers with which national banks directly compete have the power to sell fixed and variable annuities.

**A. The Comptroller's Approval**

In August 1989, NationsBank sought approval from the Comptroller for NSI to engage in the sale, as agent, of both fixed and variable annuity contracts solely upon the order and for the account of customers and without recourse.[5] NSI proposed to offer annuities issued by a number of companies unaffiliated with NSI or NationsBank. The annuities to be offered varied as to whether they required single or multiple payments, and whether payments would accumulate solely in a variable account, a fixed account, or a combination of fixed and variable accounts. All fixed annuities to be offered would have some form of an excess interest rate feature.

On March 21, 1990, the Comptroller approved NationsBank's request. In doing so, the Comptroller relied, in part, on the "incidental powers" of national banks to

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[5] National banks, under applicable Comptroller regulations, may employ operating subsidiaries to engage in activities permissible for their national bank parents and "which are a part of or incidental to the business of banking." 12 C.F.R. § 5.34(c).

buy and sell a broad range of financial investment instruments for their customers under 12 U.S.C. § 24 Seventh (hereinafter "section 24 Seventh") of the National Bank Act. Pet. App. 43a. Based on the traditional role of national banks as financial intermediaries and the close functional similarity between annuities and other financial investment instruments which national banks are authorized to sell, the Comptroller concluded that fixed and variable annuities could be lawfully sold, as agent, by a national bank's operating subsidiary (as well as the national bank itself). Pet. App. 37a-41a.

The Comptroller also stated that, to the extent that the annuity contracts were securities for purposes of the Glass-Steagall Act,[6] the brokerage of the annuities also would be authorized by the express securities brokerage power for national banks set forth in that act. Pet. App. 37a.[7]

The Comptroller further concluded that 12 U.S.C. § 92 ("section 92"), which permits national banks to act as insurance agents in towns with 5,000 or fewer inhabitants, does not limit banking powers under section 24 Seventh. Consistent with the view of two courts of appeals, the Comptroller rejected the Fifth Circuit's interpretive approach set forth in *Saxon v. Georgia Ass'n of Indep. Ins. Agents, Inc.*, 399 F.2d 1010 (5th Cir. 1968) ("*Saxon*"). Rather, the Comptroller found that section 92 was merely a source of additional power, not a limitation on any powers that national banks otherwise possessed. Pet. App. 42a.

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[6] Act of June 16, 1933, ch. 89, 48 Stat. 184 (codified at 12 U.S.C. § 24 Seventh).

[7] In 1985, the Comptroller's staff had issued interpretive guidance which confirmed that national banks had the authority to broker variable annuities under section 16 of the Glass-Steagall Act. *See* OCC Ltr. No. 331, *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) 85,501, at 77,773 (Apr. 4, 1985) ("OCC Ltr. 331"). Neither VALIC nor any other annuity issuer ever challenged this published position until this case.

Moreover, the Comptroller concluded that even assuming that the interpretive approach in *Saxon* were valid, it would not preclude the brokering of annuities because annuities are not "insurance" within the meaning of section 92 since they "lack the basic insurance characteristic of indemnification against risk." Pet. App. 47a. As the Comptroller observed, "[a]lthough annuities often share with insurance the need for actuarial calculations, they are primarily a vehicle for investment, not indemnification." Pet. App. 45a. Finally, the Comptroller concluded that, even if annuities were deemed to be "insurance" under section 92, they were a specialized insurance-related product, such as credit-related insurance, and thus are not prohibited by section 92. Pet. App. 43a.

**B. The Opinion of the District Court**

In September 1990, respondent the Variable Annuity Life Insurance Co. ("VALIC") and various insurance industry trade groups filed suit in the United States District Court for the Western District of Texas challenging the Comptroller's Approval. The district court (Walter S. Smith, J.) dismissed certain plaintiffs for lack of standing and, based upon improper venue, ordered a transfer of the remaining parties to the District Court for the District of Columbia.[8] The plaintiffs then filed voluntary dismissals of the case, and VALIC alone refiled an essentially identical action in the Southern District of Texas in April 1991.[9] After limited discovery, the parties filed cross-motions for summary judgment.

The district court (Kenneth M. Hoyt, J.), adhering to this Court's seminal decision in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) ("*Chevron*"), which it found governed its review of

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[8] The prior district court decision is reported at 761 F. Supp. 1285.

[9] The district court's jurisdiction was based on 28 U.S.C. §§ 1331, 1337 and 1361.

the Comptroller's Approval, rejected VALIC's challenge and upheld the Comptroller's Approval. Pet. App. 34a. The district court stated that the "initial inquiry under *Chevron* is whether Congress has directly addressed the specific question at issue." Pet. App. 32a. The district court, on the record before it, concluded that Congress had not specifically addressed the issue of whether national banks are authorized to broker annuity contracts. *Ibid.*

The district court then proceeded to the second step of the *Chevron* analysis: Whether the Comptroller's interpretation of the National Bank Act was reasonable and, thus, entitled to deference. Relying upon the plain language of section 92 and its legislative history, both of which show that section 92 "was proposed to provide an additional source of revenue for national banks located in small towns and not to protect the markets from competing insurance agents," Pet. App. 33a, the district court concluded that the Comptroller's Approval constituted a "permissible construction" of section 92, which is "all that is required in order to secure this Court's deference" under *Chevron*. Pet. App. 34a.

The district court also found that section 92 "is silent with respect to defining the term 'insurance.'" Pet. App. 33a. "[T]his silence, coupled with the express delegation of rulemaking authority to the Comptroller, suggests that Congress explicitly 'left a gap for the [Comptroller] to fill.' " Pet. App. 33a (quoting *Chevron*, 467 U.S. at 843). The district court concluded that the Comptroller had not acted unreasonably in determining "that annuities are primarily financial investment instruments, not insurance," given that annuities lack fundamental insurance characteristics. *Ibid.* The district court further found that the "Comptroller's determination that annuities are a specialized product and not a 'broad form' of insurance to which *Saxon* applied, is reasonable." Pet. App. 34a.

**C. The Opinion of the Court of Appeals**

On appeal, a panel of the U.S. Court of Appeals for the Fifth Circuit (Goldberg, Jolly, Wiener, JJ.) reversed. Relying chiefly on the maxim of "*expressio unius est exclusio alterius*," the court of appeals first concluded that section 92 "plain[ly]" prohibits national banks from selling insurance products in towns with populations exceeding 5,000. Pet. App. 3a.[10] The court of appeals also held that the district court erroneously deferred to the Comptroller's interpretation of section 92. Deference, it held, was "not appropriate" under *Chevron* where, as in section 92, "the intent of Congress is clear" and would be "frustrate[d]" by deferring to the Comptroller. Pet. App. 9a.

With respect to the issue of whether annuities constitute "insurance," the court of appeals "disagreed" with the Comptroller, stating that "annuities are an insurance product, both historically and functionally." Pet. App. 10a. The court of appeals' conclusion was based primarily on the fact that annuities are regulated, at least in part, under state "insurance" laws and on a provision of the Internal Revenue Code of 1986 defining a "life insurance company" as a company "'issuing life insurance and annuity contracts.'" Pet. App. 11a (quoting 26 U.S.C. § 816(a)).

The court of appeals also refused to defer to the Comptroller's alternative reasoning that, even if *Saxon* were

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[10] In doing so, the court of appeals applied the interpretive approach used in *Saxon*. The court of appeals recognized that the Comptroller disagreed with *Saxon* and had relied upon two subsequent contrary court of appeals decisions, *Independent Ins. Agents of Am., Inc. v. Board of Governors*, 736 F.2d 468 (8th Cir. 1984) and *Independent Bankers Ass'n v. Heimann*, 613 F.2d 1164 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 823 (1980) ("*Heimann*"). The court of appeals rejected these two decisions because, in its view, they "discuss Saxon only in dicta." Pet. App. 8a.

applicable, the present case was distinguishable on the basis that section 92 does not apply to "specialized" insurance-related products like annuities, but only to general types of insurance. Instead, the court of appeals found that section 92 applies to "any . . . insurance company" and to "general" forms of insurance. Pet. App. 13a.

Moreover, the court of appeals rejected the Comptroller's conclusion that national banks can sell annuities as an "incidental power" under section 24 Seventh. It held that the sale of annuities cannot be deemed "necessary" to the "business of banking" by any "stretch of the imagination," without citing any authority construing section 24 Seventh to support its holding. Pet. App. 15a. The court of appeals further held that the "specific" limits on insurance activities in section 92 control over the "general" grant of power in section 24 Seventh. The court of appeals totally ignored the express statutory authority of the Glass-Steagall Act as a separate basis to support the brokering of at least certain types of annuities by national banks.

### D. The Opinion of the Court of Appeals Denying Rehearing

After the panel's ruling, NationsBank and NSI, together with the Comptroller, submitted petitions for rehearing and suggestions for rehearing *en banc*, which were denied on January 13, 1994. Of the thirteen active judges, six were disqualified from participating in the case, leaving only a bare majority of seven judges capable of rendering a decision.[11] Of the seven remaining judges, a majority of four judges issued a dissent strongly disagreeing with the prior disposition by the panel. Pet. App. 20a. They opined that, in light of the recusal situation, "it is not possible to discern the views of a substantial majority of the active judges . ... . " *Ibid.*

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[11] *See* 28 U.S.C. § 46(c); Fed. R. App. P. 35(a).

The dissenting judges stated that the panel "badly erred" in adopting a view that contravened *Chevron*. *Ibid.* They observed that section 92 "nowhere defines 'insurance'"; accordingly, the panel was obliged to take the second step of the *Chevron* analysis, which it refused to do. Pet. App. 24a. Under the second step of *Chevron*, the dissent concluded that the panel should have "le[ft] it to the Comptroller to arrive at a reasonable definition, insofar as it relates to the industry within his jurisdiction, namely, banking." *Ibid.* Finding substantial case authority to support the Comptroller's Approval, much of which conflicts with and was not addressed in the panel's decision, the dissent concluded that the panel should have deferred to the Comptroller's reasonable construction of the applicable banking laws and found that national banks (and their operating subsidiaries) have the authority to sell, on an agency basis, both fixed and variable annuities. Pet. App. 27a-28a.

## SUMMARY OF ARGUMENT

In rejecting the Comptroller's determination that national banks are empowered by the federal banking laws to broker fixed and variable annuities, the court of appeals violated fundamental principles of administrative law that limit a court's role in reviewing agency constructions of statutes. These principles, which are described in *Chevron* and its progeny, require courts to defer to reasonable agency constructions where, as here, Congress has not spoken to the precise question at issue. The question in this case, therefore, is whether, under *Chevron*, the Comptroller's construction of the various statutory provisions relevant here—the incidental powers clause of section 24 Seventh, section 92, and the Glass-Steagall Act—were reasonable and consistent with the structure and purpose of the National Bank Act. The answer to this question is an overwhelming yes.

First, the Comptroller reasonably concluded that national banks were empowered to broker fixed annuities based upon the incidental powers clause of section 24 Seventh, which authorizes national banks to engage in "all such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. § 24 Seventh. The Comptroller looked to the longstanding role of banks as financial intermediaries and determined that the brokering of fixed annuities was consistent with that function. He further determined that annuities functionally resembled other investment products that national banks had long been empowered to sell and that annuities were, in fact, treated as investment products in the marketplace. Accordingly, he concluded that the sale, as agent, of annuities by national banks is authorized under section 24 Seventh.

The court of appeals erred in holding that the power to sell annuities can "by no stretch of the imagination" be deemed "necessary." The court of appeals' unduly narrow construction of the word "necessary" mistakenly treats "necessary" as synonymous with "essential." Such a construction is contrary to precedent of this Court and numerous courts of appeals, which instead have adopted a functional and dynamic mode of analysis in determining the scope of permissible national bank activities under section 24 Seventh.

Second, since at least some types of annuities are securities within the meaning of the Glass-Steagall Act, national banks also possess an express banking power to broker annuities. In a prior interpretive letter, the Comptroller's office had confirmed that national banks had the authority to broker variable annuities. That interpretation was reasonably premised upon the "functional resemblance" of variable annuities to mutual funds (which are Glass-Steagall Act securities) and upon the fact that variable annuities were "securities" under the Securities Act.

For the same reasons, at least some fixed annuities also are Glass-Steagall securities. Because national banks have express annuities brokerage authority and because it has never been contended by the respondent that section 92 is a limitation upon an express banking power, an alternative basis for reversal is that at least some annuities are Glass-Steagall securities which national banks have the express authority to broker.

Finally, the court of appeals erred in interpreting section 92 as an implied limitation on the authority of national banks to market annuities as general insurance agents. By its terms, as the Comptroller properly found, section 92 is a supplemental grant of authority providing national banks in small towns with additional sources of income from the sale of "insurance" that is not incidental to the business of banking. It does not in any way restrict the power of national banks to engage in the brokering of annuities as part of the "business of banking" under section 24 Seventh. The court of appeals' reliance on the *expressio unius* rule of construction to reach its flawed interpretation of section 92 is not only at odds with proper application of the *Chevron*, but inconsistent with other rules of construction that require statutory provisions to be construed harmoniously.

Moreover, as the Comptroller also found, annuities are not "insurance" within the meaning of section 92. In so finding, the Comptroller analyzed and contrasted the structure and features of annuities and traditional insurance products and concluded, on the basis of "the great weight of authority," that annuities lack basic insurance characteristics. Further, even if annuities somehow could be deemed to be "insurance" in the broadest sense of the word, the Comptroller concluded that they were at most a specialized insurance-related product that does not fall within the general prohibition of section 92. Under the maxim of *ejusdem generis*, section 92 only extends to the sale of broad forms of insurance. It does not extend to

more specialized insurance-related products that are functionally equivalent to many investment products, the sale of which is authorized for national banks and their operating subsidiaries.

## ARGUMENT

### I. THE COURT OF APPEALS CONTRAVENED THE *CHEVRON* DOCTRINE IN REJECTING THE COMPTROLLER'S REASONABLE CONSTRUCTION OF SECTION 24 SEVENTH AND SECTION 92.

#### A. The *Chevron* Doctrine Requires Deference to the Comptroller's Reasonable Construction of the Federal Banking Laws Which He Is Charged with Administering.

There is no dispute that the Comptroller's construction of section 24 Seventh and section 92 is at the heart of this case. The proper role of a court reviewing an agency's construction of a statute which it administers was unambiguously delineated by this Court in *Chevron*, a decision which "has established itself as one of the very few defining cases in the last twenty years of American public law." Cass R. Sunstein, *Law and Administration After Chevron*, 90 Colum. L. Rev. 2071, 2075 (1990).

Under *Chevron*, a court must first consider "whether Congress has directly spoken to the precise question at issue." 467 U.S. at 842. If the intent of Congress is clear, "that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Id.* at 842-43. If the statute is "silent or ambiguous," the question for the court is then whether the agency's decision "is based on a permissible construction of the statute." *Id.* at 843. In making that determination, "[t]he court need not conclude that the agency construction was the only one it permissibly could have adopted to uphold the construction, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding." *Id.* at 843 n.11. Pro-

vided that the agency's construction is "'rational and consistent with the statute,'" it must be upheld as "permissible." *Pension Benefit Guar. Corp. v. LTV Corp.*, 496 U.S. 633, 650 (1990) (quoting *NLRB v. United Food & Commercial Workers Local 23*, 484 U.S. 112, 123 (1987)).

Deference is particularly compelling where, as here, the regulatory scheme is "complex and highly technical" and where the issues in question "require significant expertise, and entail the exercise of judgment grounded in policy concerns." *Pauley v. Bethenergy Mines, Inc.*, 501 U.S. 680, 697 (1991); *see also Chevron*, 467 U.S. at 865; *Independent Bankers Ass'n v. Clarke*, 917 F.2d 1126, 1129 (8th Cir. 1990) (the "regulatory and competitive [banking] environment is especially suited to the expert judgment of regulators").

Applying *Chevron*, in the present case, there can be no question that Congress "has [not] directly spoken" to the issues of whether annuities can be sold under section 24 Seventh or whether annuities are "insurance" within the meaning of section 92. The term "insurance" is nowhere defined, and indeed the term "annuities" does not appear, in either of these sections or their respective legislative histories. There is, therefore, nothing indicating Congress' intent—much less the clear Congressional intent required by *Chevron*—that annuities cannot be sold by national banks under the federal banking laws. Congress simply has never addressed this "precise question."

In these circumstances, under *Chevron*, the court of appeals wrongly reversed the district court and failed to defer to the reasonable interpretations of the Comptroller. As is shown in Sections II and III below, the court of appeals refused to accord the Comptroller the level of deference required by this Court's teachings. In fact, the court of appeals accorded the Comptroller no deference at all in this matter. While paying lip-service to *Chevron*, the court instead did precisely what *Chevron* forbids—it in-

appropriately engaged in a *de novo* analysis and "substitute[d] its own construction of [sections 24 Seventh and 92] for a reasonable interpretation made by [the Comptroller]," the expert regulator. *Chevron*, 467 U.S. at 844.

**B. The Failure to Grant Deference to the Comptroller's Reasonable Construction of the Federal Banking Laws at Issue Here Undermines the Critical Role Vested In the Comptroller by Congress.**

By failing to grant the Comptroller's interpretations any measure of real deference, the court of appeals undermined the essential role of the Comptroller as the primary regulator of national banks. The Comptroller is specifically charged by Congress with the regulation of national banks and the interpretation and enforcement of the National Bank Act and the Glass-Steagall Act. *See* 12 U.S.C. § 1, *et seq.*; *Clarke v. Securities Indus. Ass'n*, 479 U.S. 388, 403-04 (1987); *Investment Co. Inst. v. Camp*, 401 U.S. 617, 626-27 (1971). The Comptroller's interpretations and rulings govern, in minute detail, many facets of a national bank's operations, including the permissible scope of banking activities. *See Heimann*, 613 F.2d at 1168 ("National banks are perhaps as meticulously regulated as any industry. Every aspect of their affairs is scrutinized . . . .") The judicial invalidation of entirely reasonable and appropriate Comptroller determinations, such as is the case here, vitiates the critical regulatory authority Congress intended the Comptroller to possess. It also creates substantial uncertainty as to whether the national banks can safely rely on the Comptroller's determinations, no matter how reasonably based. These elements are essential ingredients for an orderly and effective national banking system to exist.

Since the enactment of the National Bank Act over 130 years ago, there have been massive changes in the business of banking and in the products and services offered to

consumers by providers of retail financial services, such as banks. With respect to national banks, these changes have been accommodated primarily by evolving administrative interpretations based upon statutory language, which has changed relatively little over the years. Thus, although the statutory provisions governing national banks' powers have remained largely static since the enactment of the National Bank Act, this Court has considered and upheld administrative determinations by the Comptroller and other banking agencies permitting new and expanded activities not explicitly granted by Congress. *See, e.g., Clarke v. Securities Indus. Ass'n*, 479 U.S. at 390-91 (the offering by a national bank's operating subsidiary of discount brokerage services other than at the bank's branch offices); *Board of Governors v. Investment Co. Inst.*, 450 U.S. 46, 49 (1981) (the provision by a bank holding company or its nonbanking subsidiary of investment advisory services to a closed-end investment company).

If national banks could not rely upon such regulatory interpretations they would be unable to respond to the changing demands and needs of their customers and their competitive position vis-a-vis other financial services providers would quickly erode. Such an anomalous result would be clearly contrary to the intent of Congress and would eviscerate the regulatory discretion which Congress wanted the Comptroller to have in a dynamic financial services marketplace.

## II. NATIONAL BANKS ARE EMPOWERED BY THE INCIDENTAL POWERS CLAUSE OF THE NATIONAL BANK ACT AND BY THE GLASS-STEAGALL ACT TO SELL FIXED AND VARIABLE ANNUITIES TO THEIR CUSTOMERS.

### A. The Comptroller's Conclusion that the Incidental Powers Clause Permits the Brokerage of Fixed Annuities Was Supported by a Functional Approach to the Powers of National Banks and the Structure and Features of Annuity Contracts.

The Comptroller's Approval found that national banks, and their operating subsidiaries, have the authority to sell fixed annuities, as agent, based upon the provision in the National Bank Act granting "all such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. § 24 Seventh. In construing the National Bank Act's "incidental powers" clause to encompass the brokerage of fixed annuities, the Comptroller found two different bases to support his determination.

First, the Comptroller commenced his analysis by noting that national banks' "traditional role as financial intermediaries [required that they] have broad powers to buy and sell financial investment instruments as agent for customers." Pet. App. 38a. The Comptroller observed that national banks have long engaged in the brokerage of securities for their customers, a power expressly confirmed by Congress in 1933 in the Glass-Steagall Act. *Securities Indus. Ass'n v. Board of Governors*, 468 U.S. 207, 215 (1984); *Block v. Pennsylvania Exch. Bank*, 253 N.Y. 227, 232, 170 N.E. 900, 901-02 (1930) (securities brokerage by banks is so widespread that "it may be the subject of judicial notice") (Cardozo, CJ). However, the power to broker financial investment products has not been limited to traditional securities products, but has been found by the Comptroller to include a wide variety of financial investment products, including equity interests in real estate,

various types of options, agricultural and metals futures, and various types of financial futures.[12]

Consistent with the analysis underlying these precedents, the Comptroller concluded that, in the current retail investments marketplace, fixed annuities "are primarily financial investments." Pet. App. 38a. Annuities are widely considered by issuers, agents and consumers to be investment products comparable to many other investment products sold by retail financial service providers. The Comptroller cited numerous supporting authorities, including two instructive decisions of this Court,[13] that found that an annuity was predominantly an investment product and not a traditional insurance product indemnifying against a risk of loss. *Ibid.*

Second, using a functional analysis, the Comptroller found a "close functional resemblance between fixed annuity contracts and other financial investment instruments that banks may sell as agent." Pet. App. 39a. Specifically, the Comptroller found a strong functional similarity between fixed annuities and variable annuities, debt instruments, and certificates of deposit, each of which is a product that national banks have the power to sell to their customers. Pet. App. 39a-41a. "The financial marketplace

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[12] OCC Ltr. No. 271, *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,435, at 77,577 (Sept. 21, 1983) (equity interests in real estate); OCC Ltr. No. 356, *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,526, at 77,818 (Jan. 7, 1986) (agricultural and metals futures used for hedging); OCC Ltr. No. 357, *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,527, at 77,819 (Feb. 26, 1986) (options on financial instruments and on financial futures); OCC Ltr. No. 365, *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,535, at 77,8332 (Aug. 11, 1986) (financial futures); OCC Ltr. No. 494, *reprinted in* [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,083, at 71,203 (Dec. 20, 1989) (agricultural, oil, and metals futures and options).

[13] *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 207-08 (1967); *Helvering v. Le Gierse*, 312 U.S. 531, 542 (1941).

provides many examples of instruments that, like fixed annuities, pay the investor a fixed stream of income over time in return for an initial investment." Pet. App. 41a.

### B. The Comptroller's Construction of the Incidental Powers Clause Was Based upon a Considered Analysis and a Rational Finding that Annuities Are Financial Investment Products.

The court of appeals decision ignored the Comptroller's construction of the incidental powers clause, other than the following lone sentence: "Even conceding arguendo that the power to sell annuities would be incidental to banking, by no stretch of the imagination can that power be deemed 'necessary.'" Pet. App. 15a. The court of appeals instead relied primarily upon the argument that the more "specific" provisions of section 92 control over the more "general grant of power" contained in section 24 Seventh, an argument which, as shown below, is seriously flawed. *See infra* at 37-40.

The cursory treatment that the court of appeals gave to the Comptroller's construction of the incidental powers clause makes it difficult to ascertain the precise basis for the court of appeals' conclusion. It appears that the court construed the word "necessary" to mean that a power must be "absolutely essential" or "indispensable" to the business of banking in order for it to be permissible.

This construction is inconsistent with this Court's interpretation of "necessary" in a variety of other contexts. Generally, this Court has not construed "necessary" to mean "absolutely necessary" or "indispensable," but rather to mean "appropriate" or "reasonably conducive to the end to be accomplished." *See Armour & Co. v. Wantock*, 323 U.S. 126, 129-30 (1944) (in interpreting a provision of the Fair Labor Standards Act of 1938, the Court said that "the word 'necessary' . . . has always been recognized as a word to be harmonized with its context") (citing *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 413, 414 (1819));

*Welch v. Helvering*, 290 U.S. 111, 113 (1933) (in determining the meaning of "ordinary and necessary expenses" in carrying on a business, "necessary" construed to mean "appropriate and helpful").

Indeed, this Court has construed the "necessary and proper" clause of Article I, section 8, clause 18 of the Constitution, as "not limited to such measures as are absolutely and indispensably necessary, without which the powers granted must fail of execution; but they include all appropriate means which are conducive or adapted to the end to be accomplished, and which in the judgment of Congress will most advantageously effect it." *Legal Tender Case*, 110 U.S. 421, 440 (1884). *See also M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) at 413-15 (necessary "frequently imports no more than that one thing is convenient, or useful, or essential to another."). *See also infra* at 26-28.

In any event, the argument with respect to "necessity" is misdirected, since the legitimate issue is whether the Comptroller acted permissibly under *Chevron*. The Comptroller can hardly be questioned as to the reasonableness of his determination that the brokering of annuities is "incidental" to the business of banking. The Comptroller, first, looked to the role of banks as financial intermediaries and determined that brokering fixed annuities was consistent with that role. The Comptroller, then, closely analyzed the modern structure and usage of fixed annuity contracts and found that they bore a close functional resemblance to other investment products that national banks have long been permitted to sell to their customers. This is exactly the type of expert regulatory judgment the Comptroller is authorized and expected to make by Congress.

The analytical approach employed by the Comptroller is both reasonable and consistent with the overall design and purpose of the National Bank Act. *See, e.g., Crandon v. United States*, 494 U.S. 152, 158 (1990) (in construing stat-

ute, court' must look to "design of the statute as a whole and to its object and policy"); *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291 (1988); *Independent Bankers Ass'n v. Clarke*, 917 F.2d 1126 (8th Cir. 1990) (Arnold, J.) (upholding Comptroller's functional definition of the term "State bank"). In the *Independent Bankers* case, for example, the Eighth Circuit upheld the Comptroller's conclusion that savings and loan institutions fall within the term "State banks" in the McFadden Act. There, as here, the Comptroller's conclusion was based on a "practical" and "functional" approach to the term "State banks." *Independent Bankers*, 917 F.2d at 1129. The Comptroller had found that savings and loan institutions engage in virtually the same financial activities as commercial banks. *Id.* at 1128. The Eighth Circuit noted that "everyone with a nodding acquaintance with the modern development of the financial industry" recognizes that former bright-line distinctions had "blurred." *Ibid.* Given "the realities of banking in the nineties," the court held that the Comptroller's functional approach was "well within the bounds of reason." *Id.* at 1129.

In the courts below, VALIC's criticism of the Comptroller was not with his analytical approach in construing the incidental powers clause, but with the Comptroller's factual finding that a fixed annuity was functionally an investment product. In this regard, the Comptroller was certainly entitled to look beneath the surface qualities of annuities to their underlying substantive characteristics, including how they are treated in today's financial services marketplace. *Cf. SEC v. United Benefit Life Ins. Co.*, 387 U.S. at 211 (quoting *SEC v. Joiner Leasing Corp.*, 320 U.S. 344, 352-353 (1943)) (The test for what constitutes an "investment contract" under section 2 of the Securities Act "is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.").

On the basis of that analysis, he certainly could reasonably conclude that annuities are, in essence, tax-advantaged investment products that are typically marketed as such in direct competition with mutual funds, certificates of deposit and equity and fixed income securities.

There is a wealth of readily available information from which the Comptroller could determine the basis on which annuities are actually marketed to the public and the features of annuities that are important to potential investors. Indeed, newspaper advertisements and business publications directed at the investing public amply demonstrate these facts. *See, e.g., The Wall Street Journal*, Apr. 29, 1991, at C3 (advertisement for Fidelity Investments Brokerage Services) ("Choose from a wide variety of investments. From zero coupon bonds to unit investment trusts, stocks to options, mutual funds, annuities and much more, Fidelity gives you an unparalleled choice of investments"); *The Wall Street Journal*, May 13, 1991, at C13 (Seligman advertisement) ("Seligman has joined The Mutual Benefit Life Insurance Company to provide a tax-deferred variable annuity investment program for individuals. It also serves as the underlying investment program in what we believe is the most intelligent 401(k) plan yet devised . . . ."); Amy Dunkin, *Annuities: Gleaning Hard Facts From the Hard Sell*, Bus. Wk., Apr. 29, 1991, at 100 (annuities have been enhanced with "bells and whistles" to compete with mutual funds); Peter Weaver, *Annuities: An Old Product With Some New Wrinkles*, Nation's Business, June 1991, at 71 (annuities have "come up with all sorts of investment and payout options").[14]

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[14] These examples from the press were among those presented in NationsBank brief to the court of appeals. NationsBank Brief in the court of appeals at 46-48. While the Comptroller may not have actually looked at any of these specific materials, they are representative of the types of advertisements that are in wide use today. Since VALIC attacked the reasonableness of the Comptroller's finding that annuities

While some, but certainly not all, annuities may incorporate a mortality-related feature (*i.e.*, payments that end upon death), the Comptroller nonetheless could reasonably conclude that annuities are predominantly investment products rather than an insurance product protecting against catastrophic losses. Pet. App. 38a. Indeed, VALIC concedes that not all fixed and variable annuities contain a mortality-related feature. VALIC Brief in the court of appeals at 35-36 n.14. Moreover, even with respect to annuities that do have a mortality-related feature, the Comptroller clearly had a sufficient basis for finding that the mortality risk in an annuity contract is essentially an investment rather than an insurance risk because it acts in the exact opposite manner from life insurance. One is a lifetime investment agreement that benefits its purchaser; the other provides death benefits for the purchaser's surviving designated beneficiaries. As this Court has previously observed, "[a]ny risk that the prepayment [premium] would earn less than the amount paid to respondent as an annuity was an investment risk similar to the risk assumed by a bank; it was not an insurance risk . . . ." *Helvering v. Le Gierse*, 312 U.S. at 542.

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are investment products, publicly available information of this type can be considered by this Court. The propriety of considering such materials has been acknowledged since the time of *Muller v. Oregon*, 208 U.S. 412, 420-21 (1908).

### C. The Comptroller's Construction of the Incidental Powers Clause and His Analytical Approach Were Consistent with the Decisions of This Court and Significant Lower Court Decisions.

The Comptroller's construction of the incidental powers clause was consistent with the decisional law which has interpreted the incidental powers clause dynamically and functionally, and has never required a banking activity to be "indispensable" in order for it to be "incidental" or "necessary" to the business of banking. *Cf. Legal Tender Case, supra; M'Culloch v. Maryland, supra.*

In *Franklin Nat'l Bank v. New York,* 347 U.S. 373 (1954), the most recent case decided by this Court directly involving the incidental powers clause, this Court was required to consider whether a New York statute could prohibit a national bank from using the word "saving" or "savings" in its advertising or in the course of its business. In invalidating the New York statute, this Court construed the incidental powers clause as follows:

> Modern competition for business finds advertising one of the most usual and useful of weapons. We cannot believe that the incidental powers granted to national banks should be construed so narrowly as to preclude the use of advertising in any branch of their authorized business. It would require some affirmative indication to justify an interpretation that would permit a national bank to engage in a business but gave no right to let the public know about it.

*Id.* at 377-78. The use of the phrase "usual and useful" as well as the nature of the banking "activity" in question—advertising—certainly suggests that this Court endorsed a more flexible standard for determining the validity of an incidental banking power. This is in marked contrast to the draconian standard advanced by VALIC that would

require that a banking activity be absolutely indispensable to the conduct of the business of banking.

The Court's approval of this more flexible standard of construction also was reflected in the consideration in *Franklin* of the Federal Reserve Act, which the Court said should not "be construed to freeze individual banks . . . to the customs and practices [in use] preceding the statute." 347 U.S. at 377. This language strongly suggests a recognition of the dynamic nature of the banking industry, and the concomitant need for the nation's banking laws to be applied with appropriate flexibility.

In *Colorado Nat'l Bank v. Bedford*, 310 U.S. 41 (1940), this Court held that national banks were authorized as an incidental power to operate a safety-deposit business. This Court considered it particularly relevant that banks, including competing state banks, commonly provided safety deposit services. This Court did not suggest, however, that the operation of a safety-deposit service was absolutely indispensable or necessary to the business of banking. Nonetheless, the Court determined that provision of this service was permissible for national banks.

More broadly, in its analyses of cases arising under the incidental powers clause, this Court has often reasoned by analogy, just as the Comptroller did when he compared the brokerage of annuities to the sale of certificates of deposit and other financial investment instruments. In *Colorado Nat'l Bank v. Bedford*, the Court reasoned that operation of a safety-deposit business was an incidental power because it was similar to a national bank's express power to accept special deposits.[15] Likewise, in *Merchants' Bank v. State Bank*, 77 U.S. (10 Wall.) 604, 648 (1871) (certification of checks upheld as an incidental power), the Court recognized the close similarity between certifying checks

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[15] Special deposits "are monies and other valuables the identical deposits of which are kept, preserved and returned in kind." 310 U.S. at 49.

and the express power granted by the National Bank Act to discount and negotiate bills of exchange. In *Clement Nat'l Bank v. Vermont*, 231 U.S. 120, 139-40 (1913) (paying state taxes on behalf of depositors upheld as an incidental power), the Court determined that collecting taxes for depositors is similar to the express power of national banks to receive deposits. Finally, in *First Nat'l Bank v. City of Hartford*, 273 U.S. 548, 559-60 (1927) (sale of certain mortgages and other evidences of debt upheld as an incidental power), the Court found that these activities were closely related to the express power to loan money and to discount and negotiate other evidences of debt.[16]

The leading court of appeals decisions generally take a similar analytical approach, and reject a finding of indispensability as a necessary ingredient to determine that a particular activity is permissible as an incidental banking power. *First Nat'l Bank v. Taylor*, 907 F.2d 775, 778 (8th Cir.) (offering of debt cancellation contracts is incidental because it is useful to the bank by providing bank customers a convenient method of paying off a bank loan in case of death) ("The 'incidental powers' of national banks are not limited to activities that are deemed essential to the exercise of express powers"), *cert. denied*, 448 U.S. 972 (1990); *Securities Indus. Ass'n v. Clarke*, 885 F.2d

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[16] This Court also has looked to the importance of an activity to the economic vitality of national banks and of commerce and business generally. In *Merchants' Bank v. State Bank*, the Court noted that the practice of certifying checks had "grown out of the business needs of the country," and said that "we could hardly inflict a severer blow upon the commerce and business of the country than by throwing doubt on their validity." 77 U.S. at 648. Likewise, in *First Nat'l Bank v. City of Hartford*, the Court reasoned that "the exercise of this incidental power has become of great importance in the business of national banks," and cited statistics of the Comptroller as proof. 273 U.S. at 560. National banks' ability to sell annuities is as critically important to the retention of their competitive position at this time as their prior activities were in earlier times.

1034, 1049 (2d Cir. 1989) (sale of mortgage "passthrough" certificates authorized by the National Bank Act because "convenient and useful" in connection with bank's sale of mortgage loans), *cert. denied*, 493 U.S. 1070 (1990); *American Ins. Ass'n v. Clarke*, 865 F.2d 278, 281-82 (D.C. Cir. 1988) (sale of municipal bond insurance by national bank subsidiary falls within incidental powers because the insurance is essentially a credit product); *M & M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977) (National Bank Act authorizes personal property leasing that is incidental to national bank's express power to "loan money on personal property"), *cert. denied*, 436 U.S. 956 (1978); *Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 430, 433-34 (1st Cir. 1972) (operation of full-scale travel agency not within incidental powers because not convenient or useful in connection with any express power) ("[A] *sine qua non* standard would be an inappropriate measure of a national bank's incidental powers under 12 U.S.C. § 24, Seventh .... We do not believe 'necessary' was there used to connote that which is indispensable.").

The reasonableness of the Comptroller's construction of the incidental powers clause also draws significant support from the recent unanimous decision of the New York Court of Appeals, affirming the New York State Banking Department's determination that the sale of annuities is an incidental banking power of state-chartered banks. *New York State Ass'n of Life Underwriters, supra.*[17] The New York court rejected the argument that the New York

[17] The New York Court of Appeals granted considerable deference to the Banking Department, because it was "presumed to have the requisite knowledge and understanding of the operational practices" of banks, leading it to apply a standard of review as to whether the Department's construction "was not unreasonable or irrational." 83 N.Y.2d at 360, 632 N.E.2d at 879. Certainly, the Comptroller should be entitled to no less deference here with respect to federal banking laws which he administers.

equivalent of the federal incidental powers clause should be narrowly construed.[18] Instead, it afforded the provision a "flexible" meaning, reasoning that the "business of banking" is "not [a] static" concept, 83 N.Y.2d at 361, 632 N.E.2d at 880, but rather should reflect the "ever-changing demands of the banking business." 83 N.Y.2d at 363, 632 N.E.2d at 881. Exactly the same analysis applies in this case.

By engaging in a comprehensive analysis which included a functional comparison of the brokerage of annuities to other well-settled activities authorized for national banks and a detailed consideration of the realities of the modern financial marketplace and the treatment of annuities within that marketplace, the Comptroller acted well within the bounds of the powers Congress vested in him and existing case law. The Comptroller's interpretive approach is fully consistent with analytical approaches sanctioned by this Court and by lower courts and, thus, is entitled to the protection against judicial encroachment accorded by *Chevron*.

### D. Since At Least Some Types of Annuities Are Securities Within the Meaning of the Glass-Steagall Act, National Banks Also Possess an Express Banking Power to Broker Them.

The Glass-Steagall Act expressly authorizes national banks to engage in the business of "purchasing and selling

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[18] The "incidental powers" clause of the New York Banking Law was the predecessor of section 24 Seventh as originally enacted in the National Bank Act of 1863. *See* Edward L. Symons, *The "Business of Banking" in Historical Perspective*, 51 Geo. Wash. L. Rev. 676, 689 (1983). Accordingly, the interpretation given to the New York clause clearly is instructive as to the meaning to be given to the comparable federal provision. *See* 2B N. Singer, *Sutherland Stat. Const.*, §§ 51.01, 51.06 (5th ed. 1992). Indeed, soon after the enactment of the National Bank Act, this Court found it relevant that its interpretation of the National Bank Act was consistent with that given to state banking law in states such as New York. *See Bank v. Lanier*, 78 U.S. (11 Wall.) 369 (1871).

. . . securities and stock without recourse, solely upon the order, and for the account of, customers . . . ." 12 U.S.C. § 24 Seventh. This authority, as noted previously, is equally applicable to operating subsidiaries of national banks. 12 C.F.R. § 5.34(d)(2).

Well prior to the Comptroller's Approval, in interpretive guidance issued in 1985, the Comptroller's staff confirmed, in OCC Ltr. No. 331, that national banks have the authority to broker variable annuities under the Glass-Steagall Act. OCC Ltr. No. 331 was reaffirmed by the Comptroller's staff thereafter. *See, e.g.*, OCC Ltr. No. 415, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,639, at 78,000 (Feb. 12, 1988); OCC Ltr. No. 429, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,653, at 78,032 (May 19, 1988).

The Comptroller's Approval stated as follows: "To the extent that the [Annuity] Contracts are Glass-Steagall securities, they would fall within the securities brokerage authority in 12 U.S.C. § 24(7) as well." Pet. App. 37a. The Chief Counsel's Letter, which served as the underlying legal basis for the Comptroller's Approval, makes clear that this reference was, at least in part, to OCC Ltr. 331. App. 3a. The Chief Counsel noted that the earlier interpretive guidance had concluded that variable annuities were Glass-Steagall Act securities based upon their "functional[ ] resembl[ance]" to mutual funds shares. *Ibid.*. The Chief Counsel's Letter and the Comptroller's Approval did not reach the issue of whether all fixed annuities were Glass-Steagall securities. In view of the respective findings in these letters that the brokerage of fixed annuities "is permissible because it is within banks' power to broker financial investment instruments" generally, it was unnecessary to more fully address this issue. Pet. App. 38a; App. 4a.

Nevertheless, the judgment of the court of appeals effectively prohibits national banks not located in small towns

from brokering any form of annuities contracts, including variable annuities. The brokerage of variable annuities was allowed prior to the Comptroller's Approval and was expressly reaffirmed by the Comptroller's Approval.[19] NationsBank and NSI had maintained before the district court and the court of appeals that the Glass-Steagall Act also authorized national banks to broker all types of annuities under such act. The district court had acknowledged the Comptroller's finding that, to the extent that the annuities at issue in the case were "Glass-Steagall securities, they would also fall within the securities brokerage authority of national banks." Pet. App. 33a.

The district court was not required to dwell at length on this issue in light of its ultimate decision upholding annuities brokerage under the incidental powers clause. The court of appeals did err, however, in not reaching the Glass-Steagall Act issue given its disposition of the other issues in the case. This Court may not be required, of course, to reach the issue as to whether national banks have the authority to broker annuities under the Glass-Steagall Act, if it otherwise determines that the court of appeals was in error and finds that national banks (and their operating subsidiaries) have the power to sell annuities. However, the issue is clearly presented by the facts and record of the case and is subsumed in the questions presented in the petitions for certiorari granted by this Court.

Any analysis of the application of the express brokerage power under the Glass-Steagall Act to annuities should begin with OCC Ltr. 331. The finding in OCC Ltr. No. 331 that variable annuities are Glass-Steagall Act "securities" had two stated bases. First, the Comptroller's staff relied upon the close functional similarity between variable annuities and mutual funds shares, which are concededly

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[19] The Complaint in this case clearly challenged NSI's authority to broker all forms of annuity contracts.

securities under the Glass-Steagall Act. The staff had noted that this Court in *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 211 (1967), and the Federal Reserve Board in its regulations, 12 C.F.R. § 218.112, had relied upon the close comparability of variable annuities to mutual funds as a basis for finding them to be securities in other statutory contexts.

Second, the Comptroller's staff relied upon the fact that variable annuities are securities under the Securities Act.[20] Although the Comptroller has acknowledged that status as a security under the Securities Act is not necessarily dispositive of status as a security under the Glass-Steagall Act, it was reasonable to view the status of an instrument under the Securities Act as "highly relevant" to whether it should be found to be a security under the Glass-Steagall Act.[21] *See Securities Indus. Ass'n v. Board of Governors*, 807 F.2d 1052, 1063 (D.C. Cir. 1986), ("[W]e must consider Congress' understanding of the financial terms it used in one statute [the Securities Act] highly relevant to discovering the meaning attached to similar but ambiguous terms in the other [the Glass-Steagall Act]."), *cert. denied*, 483 U.S. 1005 (1987).[22]

Even without reference to OCC Ltr. 331, the conclusion that at least certain types of annuities are Glass-Steagall securities is compelling and by itself graphically illustrates the flawed reasoning of the court of appeals regarding deference. The Glass-Steagall Act does not explicitly define the term "securities," although the statute's use of the phrase "securities and stock" clearly implies that "securities" were intended to include more than simply stock.

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[20] Pet. App. 37a & n.2.

[21] Congress enacted the Glass-Steagall Act and the Securities Act within days of one another.

[22] *See also* OCC Ltr. No. 388, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,612, at 77,938 (June 16, 1987); *Securities Indus. Ass'n v. Board of Governors*, 468 U.S. 137, 150-52 (1984).

Moreover, the legislative history of the Glass-Steagall Act does not reflect any clear definition of the term "securities" on the part of its legislative draftsmen. Given the absence of an express definition by Congress, the term "securities" is precisely the type of term that regulatory agencies and courts are permitted to define on the basis of experience, policy and reason.

The fact that various federal agencies and courts acting under a variety of federal statutes have concluded that at least variable and some types of fixed annuities are "securities" is persuasive support for a similar meaning under the Glass-Steagall Act, given the absence of any legislative history to the contrary. *Oscar Mayer & Co. v. Evans*, 441 U.S. 750, 755-56 (1979) (construing statutory provisions with "common purpose" and language that is in *haec verba* to have same meaning); *Securities Industry Ass'n v. Board of Governors*, 807 F.2d at 1063 (meaning of the term "underwriter" in the Securities Act is "highly relevant to discovering the meaning attached to similar but ambiguous terms" in the Glass-Steagall Act), *cert. denied*, 483 U.S. 1005 (1987); *United States v. Stauffer Chem. Co.*, 684 F.2d 1174, 1187-89 (6th Cir. 1982) (similar language in Clean Water Act and Clean Air Act should be given similar construction), *aff'd*, 464 U.S. 165 (1984).

At least some fixed annuities also share the status of variable annuities as "securities" under the Securities Act. Section 3 of the Securities Act, entitled "Exempted Securities," provides an exemption from the registration requirements of the Securities Act to any of the following *classes of securities*:

> *Any* insurance or endowment policy or *annuity contract* or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions,

> of any State or Territory of the United States or the District of Columbia.

15 U.S.C. § 77c(a)(8) (1982) (emphasis added). It would clearly have been unnecessary for Congress to have exempted annuities from the registration requirements of the Securities Act if Congress did not consider them to be securities.

Moreover, the Securities and Exchange Commission ("SEC") also appears to have concluded that at least particular types of fixed annuities are securities under the Securities Act. Rule 151, adopted in 1986 by the SEC under section 3(a)(8) of the Securities Act, provides a safe harbor exemption from *registration* under the Securities Act for qualifying fixed annuities. It presumably would have been unnecessary for the SEC to provide the Rule 151 safe harbor if it had concluded that fixed annuities were not *per se* securities for purposes of the Securities Act. Indeed, in the SEC Release accompanying Rule 151, the SEC indicated that Rule 151 "does not attempt to identify the outer limits of section 3(a)(8) beyond which a contract, though denominated 'insurance,' is a security subject to federal regulation." SEC Release No. 33-6645, 35 SEC Docket (CCH) 952, 953 (May 29, 1986), 51 Fed. Reg. 20,254, 20,255 (1986) (codified at 17 C.F.R. § 230.151).

This Court also has stated that fixed annuities, at least in certain circumstances, like variable annuities, are securities under the Securities Act. In *SEC v. VALIC*, in which it determined that variable annuities were not exempt from the registration requirements of the Securities Act, this Court stated that "the term 'security' as defined in the Securities Act is broad enough to include any 'annuity' contract." *SEC v. VALIC*, 359 U.S. at 67-68 (footnote omitted) (emphasis added); *see also SEC v. United Benefit Life Ins. Co.*, 387 U.S. at 210 (1967).

In *Otto v. Variable Annuity Life Ins. Co.*, 814 F.2d 1127, 1140-42 (7th Cir. 1986) (opinion on rehearing), *cert. denied*,

486 U.S. 1026 (1988), the Seventh Circuit directly addressed the status of fixed annuities under the federal securities laws. This case concerned a fixed annuity that created a general obligation of the issuing insurance company, and provided for a guaranteed minimum interest rate. The fixed annuity also provided for excess interest to be credited solely at the discretion of the issuer. Since the issuer did not limit changes in the excess rate to no more frequently than once yearly, the fixed annuity did not qualify for the Rule 151 safe harbor exemption. Consequently, the court held that the fixed annuity that was the subject of the case had to be registered under the Securities Act.[23]

The Glass-Steagall Act thus provides an alternative basis for upholding the power of national banks to broker annuities. Since securities brokerage is an express banking power, one which was reaffirmed by Congress after enactment of section 92, it is not subject to the position taken by the court of appeals with respect to the incidental powers clause that the "'specific limits'" of section 92 control over the "'general grant of power'" of section 24 Seventh.[24] Pet. App. 16a (quoting *American Land Title Ass'n v. Clarke*, 968 F.2d 150, 157 (2d Cir. 1992), *cert. denied*, 113 S. Ct. 2959 (1993)). Neither the decision of the court of appeals,nor any other decision relied upon by the court below, including Saxon, held that section 92 limited express, as contrasted with "incidental," banking powers. Therefore, a decision upholding the brokerage of some or all types of annuities under the Glass-Steagall Act, as

[23] It would be anomalous, as an analytical matter, to conclude that the annuity considered in *Otto*, assuming that it had limited discretionary excess interest rate changes to no more than once a year and therefore came within the Rule 151 exemption from registration safeharbor, would not be a security at all for purposes of the Securities Act.

[24] Petitioners, of course, reject this position on its merits. *See infra* at 37-40.

an express banking power, would pretermit the need for an extended analysis of the scope of section 92.

## III. SECTION 92 IS NOT A LIMIT ON NATIONAL BANK POWERS UNDER SECTION 24 SEVENTH AND DOES NOT APPLY TO NON-INSURANCE OR SPECIALIZED INSURANCE-RELATED PRODUCTS SUCH AS ANNUITIES

### A. Section 92 Provides an Additional Grant of Power to National Banks.

By its terms, section 92 provides an express grant of supplemental power to national banks and is not, as the court of appeals held, a per se limitation on such powers. Section 92 provides that: "*in addition to* the powers now vested by law in national banking associations," national banks "may act as the agent for any fire, life or other insurance company . . ." (emphasis added). The use of the introductory phrase "in addition to" conclusively demonstrates that section 92 is a grant of additional powers to national banks, and is not intended as a limitation on bank powers under section 24 Seventh, including those authorized by the incidental powers clause. *See Heimann*, 613 F.2d at 1170 n.18 ("By its own terms," section 92 "does not address the authority of national banks in larger towns or cities to act as agents for life insurance companies.").

Nor does this reading of the National Bank Act render section 92 "partially redundant," as the court of appeals suggested. Pet. App. 17a. No party has argued that the power of national banks to engage in insurance-related activities incidental to the "business of banking" under section 24 Seventh authorizes banks to engage in an *unlimited* general insurance agency business. It is this additional authority—to sell broad forms of insurance products that are not otherwise authorized for national banks—that section 92 gave to national banks with offices in small towns. *Independent Ins. Agents of Am., Inc. v. Ludwig*, 997 F.2d 958, 959-61 (D.C. Cir. 1993) (upholding

Comptroller's interpretation of section 92 under *Chevron*). That additional authority does not in any way negate the possibility that the sale of annuities might also be either authorized pursuant to an express banking power such as Glass-Steagall authorized securities brokerage activities or sufficiently related to the business of banking to come within the incidental powers of national banks.

Although the clarity of section 92's language obviates the need to resort to the statute's legislative history, that history confirms that Congress was well aware that section 92 constituted an additional grant of national bank powers. Senator Owen, section 92's sponsor, described the provision as "giving some additional powers to the small banks to act as agents in insurance matters." 53 Cong. Rec. 11,002 (1916); *see also* 53 Cong. Rec. 11,001 (1916) (Comptroller's letter explaining that the proposal resulted from consideration of "how the powers of these small national banks might be enlarged"); *Independent Ins. Agents*, 736 F.2d at 477 n.6 ("Congress was concerned only with providing small-town banks with an additional profit source, not with prohibiting city banks from selling insurance").[25]

The Fifth Circuit, ignoring the literal language of section 92 and its legislative history, instead endeavored to divine a limitation on national bank activities through a misplaced reliance on the maxim "*expressio unius exclusio alterius*." That maxim, however, "is only an aid in the ascertainment of the meaning of the law and must yield whenever a contrary intention on the part of the law-maker is apparent." *Springer v. Government of the Philippine Islands*, 277 U.S. 189, 206 (1928). The maxim "can never override clear and contrary evidences of Congressional intent,"

[25] The district court concurred with this view of the import of the legislative history. Pet. App. 33a ("[T]he legislative history of § 92 indicates that it was proposed to provide an additional source of revenue for national banks located in small towns and not to protect the markets from competing insurance agents.").

which is present here. *Neuberger v. Commissioner*, 311 U.S. 83, 88 (1940).

Moreover, when applying the *expressio unius* rule, a court necessarily reaches its construction by negative implication based on the language of the statute. *Chevron* holds, however, that things not "directly spoken to" by Congress create a delegation of legislative authority to the administrative agency. *Chevron*, 467 U.S. at 843-44. When a court invokes the *expressio unius* rule, by definition, Congress has not "directly spoken." Thus, the *expressio unius* rule directly conflicts with application of the first step of the *Chevron* analysis, and the court of appeals improperly attempted to apply both simultaneously. *See* Sunstein, 90 Colum. L. Rev. at 2109 n.182 (recognizing that the *expressio unius* rule "is a questionable one in light of the dubious reliability of inferring specific intent from silence").

The court of appeals also erroneously held that the "specific" terms in section 92 control the "general" grant of power in section 24 Seventh. Pet. App. 15a-16a. This argument ignores the language and fundamental structure of the National Bank Act. Assuming section 92 has any application to annuities at all, *see infra* at 40-45, section 92 is no more "specific" than section 24 Seventh with respect to insurance activities. Both statutory provisions provide some authority for national banks to act as agent for insurance companies and neither expressly limits such activities.

Indeed, if there is any presumption at all, that presumption should be that section 92 and section 24 Seventh do not conflict with or limit one another. *Pauley*, 501 U.S. at 706 (agency interpretation harmonizing related statutes and regulations is "presumptively reasonable"); *Anderson v. FDIC*, 918 F.2d 1139, 1143 (4th Cir. 1990) (courts should construe statutes harmoniously, especially if they involve the same subject matter). Since its adoption of section 92

in 1916, Congress has revisited section 24 Seventh and other provisions of the National Bank Act on many occasions, perhaps most prominently in connection with the enactment of the Glass-Steagall Act. Yet on none of these occasions did Congress choose to revisit the scope of the incidental powers clause. If any tension existed between section 24 Seventh and section 92, Congress certainly has had ample opportunities to modify one or the other provision during the past 78 years. The logical presumption from this history is that Congress saw no tension because it intended no limitation on section 24 Seventh by reason of its enactment in 1916 of section 92. *Cf. United States v. Rodriguez-Rodriguez*, 863 F.2d 830, 831 (11th Cir. 1989) (an apparently specific provision may, in context, be construed as a general reference).

In sum, the Comptroller's construction of section 92 properly harmonizes the interplay between section 92 and section 24 Seventh: Section 24 Seventh grants powers incidental to the business of banking; section 92 grants additional, non-incidental banking powers. The Comptroller's interpretation is entirely consistent with the language and structure of the statute and is not "arbitrary, capricious, or manifestly contrary to the statute" under the second step of *Chevron*. *Chevron*, 467 U.S. at 844 (footnote omitted). Accordingly, the Comptroller's Approval should be upheld.

### B. Annuities Are Not "Insurance" Within the Meaning of Section 92.

Even if section 92 were found to be a limit on section 24 Seventh, annuities do not constitute "insurance" for section 92 purposes. The Comptroller's Approval determined (Pet. App. 41a-47a) that annuities are not "insurance" within the meaning of section 92. The section itself neither defines the term "insurance" nor otherwise addresses the issue of annuities. Under *Chevron*, that definitional interstice in the banking laws is one that is left

for the Comptroller to fill, provided his interpretation is reasonable. *Chevron*, 467 U.S. at 843; *see also Clarke v. Securities Indus. Ass'n*, 479 U.S. 388, 403-04 (1987). This approach is especially compelling here, since as the District Court noted, section 92 grants the Comptroller the express power to issue implementing rules and regulations. Pet. App. 33a.

The interpretation adopted by the Comptroller in this case is reasonable by any measure, and is entitled to substantial deference. The Comptroller first analyzed dictionary definitions to determine whether the term "insurance" included annuities. Not surprisingly, the Comptroller found that dictionary definitions of the term insurance "invariably" describe it as "a contract for indemnification against risk of loss." Pet. App. 43a-44a. He also considered the fact that annuities are typically marketed as investment products, particularly as "a tax-sheltered means of saving for retirement." Pet. App. 38a (footnote omitted). The Comptroller concluded, therefore, that annuity investors "are not seeking to pool a catastrophic risk," the hallmark characteristic of "insurance."[26] *Ibid.*

The Comptroller's conclusion—a reasonable statutory construction in and of itself—is reinforced by the extensive

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[26] In fact, as courts and commentators have recognized, "annuity and insurance are opposites." *Helvering v. Le Gierse*, 312 U.S. 531, 541 (1941); *accord* 1 J. Appleman, Insurance Law and Practices § 84 (1981) (the two are "diametrically opposed"). Insurance involves the payment of stated amounts over a period of years, in return for which the insurer agrees to pay a fixed amount in the event of a loss. 3A C.J.S. *Annuities 3c*, at 869. The insurer bears the risk that a loss will occur before the amount to be paid in premiums. In the case of an annuity, "[t]he positions are almost exactly reversed." 1 J. Appleman, *Insurance Law and Practices* § 84 (1981). The annuitant pays a fixed sum, in return for which the issuer must make a series of payments to the annuitant, usually over a period of years. In other words, "annuities are not indemnities for death but are investment for life." *Corporation Comm'n v. Equitable Life Assurance Soc'y*, 73 Ariz. 171, 175-76, 239 P.2d 360, 362 (1951).

case law recognizing that annuities are investment products and not insurance. *Helvering v. Le Gierse*, 312 U.S. 531, 541 (1941); *In re Young*, 806 F.2d 1303, 1306 (5th Cir. 1987) ("an annuity is essentially a form of investment") (quoting *In re Howerton*, 21 B.R. 621, 623 (Bankr. N.D. Tex. 1982); *Daniel v. Life Ins. Co.*, 102 S.W.2d 256, 260 (Tex. Civ. App. 1937) (an annuity is "essentially a form of investment"); *see also* 1 J. Appleman, *Insurance Law and Practices* § 84, at 295 (1981) ("[a]nnuity contracts must . . . be recognized as investments rather than as insurance).[27]

Despite this wealth of authority and reasoning, the court of appeals simply refused to even consider the reasonableness of the Comptroller's conclusion that annuities were not insurance under section 92. Instead, it concluded, without any attempt at meaningful analysis, that its earlier decision in *Saxon* decided the novel question presented by this case and somehow "trumped" *Chevron* deference.[28] As

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[27] As the Comptroller also noted, other courts have distinguished annuities from insurance in holding, for example, that annuities are not excludable as insurance for certain federal income tax purposes, are not insurance for purposes of the bankruptcy laws, and are not insurance under state law. *E.g., Estate of Keller v. Commissioner*, 312 U.S. 543, 544-45 (1941); *Kernochan v. United States*, 29 F. Supp. 860, 866 (Ct. Cl. 1939), *cert. denied*, 309 U.S. 675 (1940); *In re Walsh*, 19 F. Supp. 567, 571-75 (D. Minn. 1937); *In re Sothern's Estate*, 257 A.D. 574, 14 N.Y.S.2d 1, 3-4 (1939); *In re Rhodes' Estate*, 197 Misc. 232, 94 N.Y.S.2d 406, 411 (Surr. Ct. 1949); *People ex rel. Metro Life Ins. Co. v. Knapp*, 193 A.D. 413, 184 N.Y.S. 345, 347 (3d Dep't 1920), *aff'd mem.*, 231 N.Y. 630, 132 N.E. 916 (1921); *Commonwealth v. Metropolitan Life Ins. Co.*, 254 Pa. 510, 98 A. 1072, 1073 (1916); *State ex rel. Equitable Life Assurance Soc'y v. Ham*, 54 Wyo. 148, 88 P.2d 484, 488 (1939).

[28] Indeed, it is telling that even the minimal analysis in which the court of appeals engaged was flawed. For example, its reference to Black's definition of annuities (Pet. App. 10a) is taken not from the definition of "annuity," but from the definition of "annuity insurance" found under the term "insurance." Black's Law Dictionary 802-03 (6th

its initial response to the Comptroller's detailed analysis of an issue uniquely within his expertise, the court of appeals tersely stated: "We disagree." Pet. App. 10a.

The court of appeals' almost exclusive reliance on *Saxon* is misplaced. First, *Saxon* not only precedes *Chevron* by sixteen years, but also precedes a number of the decisional antecedents relied upon by *Chevron*. The *Saxon* court had no need, therefore, to address the level of deference a reviewing court owes to an administrative construction of a statute. Indeed, the *Saxon* court's entire approach to the interpretation of section 24 Seventh and section 92 was to treat the matter as one to be determined *de novo, i.e.*, as if the matter had arisen in the first instance in litigation between private parties.[29]

More importantly, the court of appeals' decision flies in the face of this Court's decision in *SEC v. VALIC*. In *SEC v. VALIC*, this Court squarely rejected the proposition, wrongly urged by VALIC in that case and again wrongly here, that because annuities are regulated by the states for certain purposes as insurance, they must be deemed insurance for all purposes. This Court found:

> [H]ow the States may have ruled is not decisive. For, as we have said, the meaning of "insurance"

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ed. 1990). The definition of "straight annuity," applicable here, provides that this product is "*distinguishable* from [a] life insurance contract." *Id.* at 91 (emphasis added).

[29] Moreover, *Saxon* merely held that national banks have no power to act as general insurance agents in towns with a population greater than 5,000. *Saxon*, 399 F.2d at 1013. Thus, as the rehearing dissent observed, this is not a case in which upholding the Comptroller requires the overruling of judicial precedent. Pet. App. 24a (the "better view" is not to apply or overrule *Saxon*, but to defer to the Comptroller's determination that annuities are financial investment instruments, not insurance). The Comptroller properly and reasonably distinguished *Saxon* on the ground that section 92 does not apply to financial investment instruments merely because they also are sold by insurance companies and are regulated, for some purposes, by state insurance authorities.

> or "annuity" under these Federal Acts is a federal question.

359 U.S. at 69. Applying federal law, the Court held that variable annuities were not insurance under the statute in question. The court of appeals ignored the analysis applied in *SEC v. VALIC* and instead erroneously focused on the "superficial" similarity between insurance and annuities.[30]

The court of appeals' decision also runs afoul of *John Hancock Mutual Life Ins. Co. v. Harris Trust & Sav. Bank*, 114 S. Ct. 517 (1993), in which the Court recently reaffirmed the vitality of *SEC v. VALIC*. In doing so, the Court explicitly emphasized that:

> "[T]he assumption of an investment risk cannot by itself create an insurance provision under the federal definition. The basic difference between a contract which to some degree is insured and a contract of insurance must be recognized."

*Id.* at 528 n.13 (quoting *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 211 (1967)). In *John Hancock*, the Court construed ERISA in light of its prior interpretation of the Securities Act. In construing the National Bank Act, the court of appeals should have done the same, but inexplicably did not.

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[30] To be sure, the court of appeals did not completely overlook *SEC v. VALIC*; however, it somehow ignored its holding. The Court's ruling, as shown above, contradicts the court of appeals' flat declaration in this case that annuities are "functionally and historically" an insurance product. Pet. App. 10a. Moreover, the court of appeals' reliance on a concurring opinion in that case as supporting its conclusion that annuities are "insurance" is particularly perplexing. *Ibid.* Justice Brennan, the author of the concurring opinion, expressly stated that the administration of the contracts at issue involved a "predominant element of the business of an *investment company*"—a fact that led him to conclude that the annuities were *not* "insurance." 359 U.S. at 81 (emphasis added).

Finally, the Comptroller's ruling that annuities are not "insurance" for federal banking law purposes draws persuasive support from the decision of the New York Court of Appeals in *New York State Ass'n of Life Underwriters, supra*. The New York Court of Appeals analyzed many of the same authorities considered by the Comptroller and concluded that "the great weight of authority supports the position that annuities are not insurance." 83 N.Y.2d at 363, 632 N.E.2d at 881. Rather, it found that annuities were comparable to other financial investment instruments that state-chartered banks commonly sell, including certificates of deposit and various types of securities. 83 N.Y.2d at 364, 632 N.E.2d at 882.

In short, the court of appeals erred by refusing to apply the *Chevron* standard of deference and by substituting its views *de novo* in an area in which it, unlike the Comptroller, lacked special expertise. Not only did the court of appeals ignore relevant case law, its decision conflicts with this Court's decisions in *SEC v. VALIC* and *John Hancock*. As a result, not surprisingly, its decision is fundamentally flawed and does not reflect the "hard [economic] realities" of annuities as a retail investment product.

### C. Annuities Are a Specialized Insurance-Related Product that Are Not Subject to Section 92.

Even assuming arguendo that annuities might constitute "insurance" in the broadest sense of that term, they are a specialized form of insurance-related product that do not come within the purview of section 92. Section 92, by its terms, applies only to a national bank acting as the "agent for any fire, life, or other insurance company." Under the principle of *ejusdem generis*—a maxim of statutory construction overlooked by the court of appeals—a general term in a statutory list "should be understood in light of the specific terms that surround it." *Hughey v. United States*, 495 U.S. 411, 419 (1990); 2A N. Singer, *Sutherland Stat. Const.* § 47.17 (5th ed. 1992).

Applying this principle, any limitation imposed by section 92 would extend only to the sale of broad forms of insurance, such as fire and life insurance, which are specifically enumerated in the provision. It would not encompass more specialized forms of insurance-related products, such as annuities, which are authorized for national banks to sell. Indeed, application of *ejusdem generis* is necessary to give independent meaning to Congress' specification of "fire" and "life" insurance in section 92. Under the court of appeals' reading of the statute, those terms become unnecessary, since all types of insurance are encompassed in the phrase "any . . . insurance company."

The Comptroller's narrower reading of section 92 as excluding specialized insurance-related products is further supported by the *Heimann* decision. In that case, the D.C. Circuit held that credit life insurance is a "limited special type of coverage" that "in no way" involved the "operations of a general life insurance business." *Heimann*, 613 F.2d at 1170. The D.C. Circuit correctly distinguished *Saxon*, to which the court of appeals slavishly (and erroneously) adhered, as "not in point" because it involved the sale of "broad forms of automobile, home, casualty and liability insurance." *Ibid.; see also Independent Ins. Agents v. Board of Governors*, 736 F.2d 468, 477 n.6 (8th Cir. 1984) ("[t]here is a strong argument that *Saxon* was wrongly decided.")

Moreover, contrary to the court of appeals' finding, the Comptroller's reading is supported by section 92's legislative history. The court of appeals references (Pet. App. 16a) documents written by the Comptroller and counsel to the Federal Reserve Board, prior to section 92's passage, purportedly to show a belief by Congress that national banks lacked authority to act as insurance agents before section 92 was enacted. *See* 53 Cong. Rec. 11,001 (1916); *Right of a National Bank To Write Insurance Through Its Officers*, 2 Fed. Res. Bull. 73, 74 (1916). But both documents refer to insurance in only general terms. 53 Cong.

Rec. 11,001 (1916) (referring to "fire, life, etc." insurance); 2 Fed. Res. Bull. at 73 (analyzing the power of national banks to write "fire, cyclone, liability and other kinds of insurance"). Neither suggests that specific kinds of insurance agency activity that are otherwise closely connected to banking would not be encompassed within the incidental powers clause of section 24 Seventh of the Glass-Steagall Act.

The Comptroller's Approval and *Heimann* also are consistent with other explicitly authorized post-*Saxon* banking activities. These activities include the sale of credit life insurance,[31] credit disability insurance,[32] municipal bond insurance,[33] mortgage life and disability insurance, involuntary unemployment insurance, and vendors single interest insurance (which protects a lender in case of loss or damage to personal property in which the lender has a security interest).[34] If the expansive and unsupportable interpretation given *Saxon* by the court of appeals is upheld, then the legality of all of the national bank activities relating to the above-enumerated specialized insurance-related products similarly would be called into question. Such a result would be highly disruptive to national banks and could have serious adverse financial implications for banks highly dependent on revenues from these financial products.

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[31] *See* 12 C.F.R. § 2.6; *Heimann*, 613 F.2d at 1168.

[32] *See* OCC Ltr. No. 283, *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,447, at 77,608 (Mar. 16, 1984); OCC Ltr. No. 495 *reprinted in* [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,084, at 71,204 (Dec. 22, 1989).

[33] *See* OCC Ltr. No. 338, *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,508, at 77,790 (May 2, 1985); *American Ins. Ass'n v. Clarke, supra.*

[34] *See* OCC Ltr. No. 283, *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,447, at 77,608 (Mar. 16, 1984).

For these reasons, the Comptroller's determination that annuities brokerage was not a general insurance agency activity was clearly reasonable, consistent with the National Bank Act, and should be upheld.

## CONCLUSION

The decision of the court of appeals should be reversed.

Respectfully submitted,

ROBERT M. KURUCZA
STEVEN S. ROSENTHAL
*Counsel of Record*
ROBERT G. BALLEN
LESLIE J. CLOUTIER
MORRISON & FOERSTER
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006
(202) 887-1500

*Counsel for NationsBank of North Carolina, N.A. and NationsBanc Securities, Inc.*

Dated: July 29, 1994

**Comptroller of the Currency**
**Administrator of National Banks**

Washington, D.C. 20219

February 12, 1990

* * *

* * *

Dear * * *:

This responds to your bank's proposal relating to sale of annuity contracts, as described in two letters from the bank's counsel, *** and subsequent telephone conversations. You have proposed that your bank ("Bank") enter into an agreement with a marketing company ("Marketing") under which the Bank and its employees would promote and sell Flexible Payment Variable Annuity certificates (the "Certificates") issued by the Integrity Life Insurance Company (the "Company") in exchange for an assignment of Marketing's commission from the Company equal to 4.25% of the premiums generated from such sales. Bank employees who sold the Certificates would receive individual commissions of 0.25%, which would come out of the Bank's commission. Neither the Bank's nor the employees' percentage interest in premiums would vary with the volume of the Certificates sold.

You also inquired about the permissibility of a percentage leasing arrangement with Marketing under which a Marketing administrator would coordinate all annuity programs in the territory from offices located in the Bank. The Bank would provide office space, supplies, office equipment, and secretarial services, in exchange for rent equal to 0.25% of the premiums of all annuities sold by the programs for which the administrator is responsible.

For the reasons given below, we believe that the Bank's proposed activities are permissible under the National Bank Act.

## The Certificates

The Certificates combine elements of variable and fixed annuities. An investor in a variable annuity contract purchases a share in an investment portfolio and then receives payments that vary according to the performance of the portfolio. A purchaser of a fixed annuity contract, in contrast, receives a fixed or minimum level of payments. Both types of contracts may have a life term.

The Certificates provide a tax-deferred investment vehicle with a wide range of investment options. A purchaser of a Certificate may allocate his investment among eight different "investment divisions" (the "Divisions"), which offer a variety of investment policies and risk and growth characteristics. Subject to certain limitations, an investor may from time to time make withdrawals against the current value of his Certificate (the "Certificate Value"), transfer funds among the investment divisions, and invest additional amounts in his Certificate.

Upon a prearranged date selected by the investor, the investor may choose to receive his Certificate Value as a lump sum or may choose from several annuity options. The annuity may be for a fixed term, for life, or for a minimum fixed term and thereafter for life. Annuity payments may be fixed in advance or may vary according to the value of the investor's Certificate Value.

Seven of the eight Divisions permit investors to purchase interests in a mutual fund (the "Trust"). The Trust is an open-end, diversified management investment company registered under the Investment Company Act of 1940 that offers its shares exclusively to separate accounts of several insurance companies to fund variable annuities. The Trust maintains seven classes of shares corresponding to seven of the Investment Divisions. These Investment Divisions are: the Common Stock Fund, the Aggressive Stock Fund, the Balanced Funds, the Bond Fund, the High Yield Fund, the Global Fund, and the Money Market Fund.

The value of an investor's share in each of these Investment Divisions depends on the performance of the underlying investment portfolio maintained by the Trust.

The eighth investment division, the "Guaranteed Interest Division," differs from the other divisions in that it offers a fixed level of interest. Funds allocated to the Guaranteed Interest Division become part of the general assets of the Company. The Company guarantees principal and interest on funds allocated to the Guaranteed Investment Division.

## Sale of the Certificates

### 1. *Authority, 12 U.S.C. § 24(7)*

The Certificates are called variable annuities, but the Guaranteed Interest Division option permits an investor to allocate some or all of his investment to what is, in effect, a fixed annuity. Although many state banks sell both types of annuities,[1] the OCC has only provided an opinion on the sale by national banks of variable annuities. *See* Interpretive Letter No. 331, April 4, 1985, *reprinted in* [1985-1987 Transfer Binder] Fed. Banking Law Rep. (CCH) ¶ 85,501. That letter stated that variable annuity contracts are securities, functionally resembling shares in a mutual fund, and that banks are authorized, pursuant to 12 U.S.C. § 24(7) to buy and sell securities for the account of customers. To the extent that the Certificates are Glass-Steagall securities, they would fall within the securities brokerage authority in 12 U.S.C. ¶ 24(7) as well. (The Certificates are registered securities under the Se-

[1] *See Annuities Sales by Banks: An Up and Coming Business,* ABA Consumer Banking Digest, Sept./Oct. 1989, at 4-9 (bank annuity sales for 1990 predicted to be $10 billion); *Bank Annuity Sales Expected to Double in 1989,* National Underwriter (Life & Health/Financial Services Ed.), January 2, 1989, at 3.

curities Act of 1933,[2] but this is not dispositive of whether they are securities for purposes of the Glass-Steagall Act.) However, since we find that brokerage of fixed annuities is a permissible activity for national banks regardless of whether fixed annuities are Glass-Steagall securities, it is unnecessary at this time to determine the status of the Certificates under the Glass-Steagall Act. Brokerage of fixed annuities is permissible because it is within banks' power to broker financial investment instruments.

As part of their traditional role as financial intermediaries, banks have broad powers to buy and sell financial investment instruments as agent for customers. The Glass-Steagall Act explicitly preserved banks' brokerage power with respect to securities, but this power antedated the Glass-Steagall Act[3] and is not limited to securities. Pursuant to this power, national banks may broker a wide variety of financial investment instruments. *See* Interpretive Letter No. 494 (December 20, 1989) (agricultural, oil, and metals futures).

Although annuities have historically been a product of insurance companies, they are primarily financial investments. Investors who purchase annuities are not seeking

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[2] Some fixed annuities are exempt from the registration requirements of the Securities Act of 1933. *See* 15 U.S.C. § 77c(a)(8) (exempting "any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia.") This exemption has been construed to apply only to fixed annuities. *See SEC v. Variable Life Ins. Co.*, 359 U.S. 65 (1959). To distinguish annuities that qualify for the exemption from those that do not, the SEC has promulgated a "safe harbor" definition, Rule 151. *See* 17 C.F.R. § 230.151(a).

[3] *See Securities Industry Association v. Federal Reserve Board*, 468 U.S. 207, 214 (1984) ("Banks long have arranged the purchase and sale of securities as an accommodation to their customers. Congress expressly endorsed this traditional banking service in 1933.").

to pool a catastrophic risk such as death, injury or property damage, but are instead seeking a guaranteed, long-term return on their assets. Most commonly, annuities are marketed as a tax-sheltered means of saving for retirement.[4] The element of mortality risk, which is present in some annuities, derives from the investor's willingness to price a contractual arrangement based on the length of his life in order to increase the return he will receive during his lifetime. This risk is essentially an investment risk, not an insurance risk. *See Helvering v. Le Gierse,* 312 U.S. 531, 542 (1941) ("Any risk that the prepayment [premium] would earn less than the amount paid to respondent as an annuity was an investment risk similar to the risk assumed by a bank; it was not an insurance risk. . . ."); *In Re Howerton,* 21 Bankr. 621, 623 (1982) ("Both life insurance and annuity contracts may take various forms but the heart of the distinction between them is this: life insurance is a promise to pay a sum certain on the death of the insured and an annuity is essentially a form of investment which pays periodically during the life of the annuitant or during a term fixed by contract rather than on the occurrence of a future contingency."); *Daniel v. Life Ins. Co. of Virginia,* 102 S.W.2d 256, 260 (Tex. Civ. App. 1937) ("[An annuity] is essentially a form of investment, and uniformly held to be such, regardless of the fact that in its usual form payments are contingent upon continuity of the life of the grantee."); 1 J. Appelman, Insurance Law and Practice, § 84 (1981) ("annuity contracts must . . . be recognized as investments rather than as insurance"). *See also SEC v. United Benefit Life Ins. Co.,* 387 U.S. 202, 207-208 (1966) ("In fixing the necessary premium [for a fixed annuity] mortality experience is a subordinate factor and the planning problem is to decide what interest and expense rates may be expected. There

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[4] *See Helping Consumers Shelter Income,* ABA Banking Journal, July 1989, at 16-21 (discussing investment and tax shelter chracteristics of annuities).

is some shifting of risk from policyholder to insurer, but no pooling of risks among policyholders. In other words, the insurer is acting in a role similar to that of a savings institution . . . ."). Thus, although annuities often share with insurance the need for actuarial calculations, they are primarily a vehicle for investment.

That fixed annuities are financial investments is further demonstrated by the close functional resemblance between fixed annuity contracts and other financial investment instruments that banks may sell as agent. First, a fixed annuity is similar to a variable annuity. Both can offer the investor a stream of payments extending over his life, and both may involve actuarial calculations. Fixed annuities differ only in that they offer a reduced level of risk, combining for the risk-averse investor the best aspects of both certificates of deposit and annuities. The only distinction between a fixed and a variable annuity—the reduced level of investment risk for the customer—provides no basis for denying to national banks the power to sell fixed annuities as agent.

Second, fixed annuity contracts resemble debt instruments, in that both involve an obligation to make a stream of payments overtime.[5] Annuities differ in form from debts in that an annuitant only has an interest in the stream of payments, whereas a creditor has a right to the total

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[5] Many courts have held that an annuity contract creates a debtor-creditor relationship. *See John Hancock Mut. Life Ins. Co. v. Helvering*, 128 F.2d 745, 751 (D.C. Cir. 1942); *Hughes v. Sun Life Assurance Co. of Canada*, 159 F.2d 110, 113 (7th Cir. 1946); *Chatham v. City Hospital*, 25 F.Supp. 614 (S.D. Ga. 1971); *Moses v. Manufactures Life Ins. Co.*, 298 F.Supp. 321 (E.D. S.C. 1968); *Roth v. Kaptowsky*, 393 Ill. 484, 66 N.E.2d 664, 669 (1946); *Crossman Co. v. Rauch*, 263 N.Y. 264, 188 N.E. 748, 751 (1934).

*See also* Land, Life Insurance Option Settlements: Trusts or Debts, 42 Col. L. Rev. 32, 35-44, 47 (1942) (advocating view that an annuity contract creates a debtor-creditor relationship, but also discussing a few cases that hold that an annuity contract creates a trust).

amount owed, though the amount may be payable only in installments.[6] But a creditor, like an annuitant, only has an enforceable interest in the periodic payments due him. Thus, the practical obligations of an annuity issuer are essentially the same as those of a debtor.[7]

Finally, a fixed annuity also functionally resembles a certificate of deposit. A fixed annuity contract for a fixed term resembles a certificate of deposit that pays interest and automatically withdraws principal at a rate calculated to reduce the balance to zero at the end of the annuity term. An annuity with a life term resembles a life interest in a certificate of deposit. The owner of a life interest in a certificate of deposit has the right to receive income from the account for life, after which ownership of the account reverts to the owner of the remainder. *See* R. Cunningham, *The Law of Property* §§ 2.16, 4.11 (1984). This is precisely the same right that the owner of a life-term annuity has.[8]

Thus, neither of the two major features of fixed annuities, the fixed return and the life term, distinguish them from other financial investment instruments that banks may buy and sell as agent. The financial marketplace provides many examples of instruments that, like fixed annuities, pay the investor a fixed stream of income over

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[6] *See Matter of Young*, 806 F.2d 1303, 1306 (5th Cir. 1987); *Commonwealth v. Beisel*, 338 Pa. 519, 13 A.2d 419 (1940).

[7] Another feature of some fixed annuities that may call the debt analogy into question is the life term, but this is really more a matter of custom and pricing than of legal significance. Nothing prevents a debtor and creditor from contracting to settle a debt by a series of payments lasting for life rather than for a term of years. *See, e.g.*, Note, *Reverse Annuity Mortgages and the Due on Sale Clause*, 32 Stan. L. Rev. 143, 145-151 (1979) (discussing reverse annuity mortgages).

[8] Although banks do not ordinarily use actuarial calculations in setting interest rates, there are no limitations on how a bank may determine the interest rate paid on a deposit.

time in return for an initial investment. The life term feature is present in some variable annuities, and a life interest in in any instrument with a fixed return is, in effect, a fixed annuity. Therefore, fixed annuity contracts are financial investment instruments that national banks have authority to sell as agent.

2. ***Insurance, 12 U.S.C. § 92***

Although brokerage of fixed annuities is within the business of banking under 12 U.S.C. § 24(7), it is also necessary to consider the relationship between 12 U.S.C. § 24(7) and 12 U.S.C. § 92, which permits national banks in towns with 5,000 or fewer people to act as agent for fire, life or other general insurance companies. Conflicting judicial interpretations of section 92 have complicated this relationship. In one case, *Saxon v. Georgia Association of Insurance Agents*, 399 F.2d 1010 (5th Cir. 1968), the court held that a national bank does not have authority to operate a general life and casualty insurance agency, arguing that the grant of insurance agency powers in section 92 implicitly prohibits national banks not located in small towns from selling fire, life, or other general insurance.

We disagree with the *Saxon* court's interpretive approach under section 92. The legislative history of section 92 indicates that the Comptroller of the Currency proposed it in 1916 to provide an additional source of revenue for national banks located in small towns.[9] The United States Courts of Appeal for the District of Columbia Circuit and the Eighth Circuit have, in dicta, construed section 92 consistently with the legislative history and have concluded that section 92 does not affect the powers of national banks located in towns that have a population larger than

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[9] *See* 53 Cong. Rec. 11001 (1916) (letter from Comptroller Williams).

5,000.[10] This has been the traditional position of the OCC.[11]

However, even under the *Saxon* court's interpretation of section 92, that section should not bar national banks from brokerage of fixed annuities. As the court observed in *IBAA v. Heimann, Saxon* should only apply to products such as "broad forms of automobile, home, casualty and liability insurance", 613 F.2d 1164, 1170 (D.C. Cir. 1979), and not to more specialized forms of insurance such as credit life insurance. This limitation on *Saxon* is implicit in section 92 itself. Section 92 concerns the power of a national bank to act as agent for "any fire, life, or other general insurance company." Under the doctrine of "ejusdem generis," general words that follow an enumeration of specific examples are read to apply only to other items akin to those specifically enumerated. This doctrine confines section 92, and therefore *Saxon,* to types of insurance that are similar to fire and life insurance, such as other general casualty insurance policies. Therefore, section 92, even as the *Saxon* court interpreted it, does not affect the power of a national bank to sell more specialized products that are incidental to the business of banking, such as title insurance, credit life and disability insurance, and debt cancellation contracts.[12] Like title insurance, credit life in-

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[10] *See IBAA v. Heimann,* 613 F.2d 1164, 1170, n. 18 (D.C. Cir. 1979), *cert. denied* 449 U.S. 823 (1980) (Section 92 "[b]y its own terms . . . does not address the authority of national banks in larger towns or cities to act as agents for life insurance companies."); *Independent Insurance Agents of America v. Board of Governors of the Federal Reserve,* 736 F.2d 468, 477, n.6 (8th Cir. 1984) ("There is a strong argument that *Saxon* was wrongly decided. The legislative history indicates that Congress was concerned only with providing small-town banks with an additional profit source, not with prohibiting city banks from selling insurance.").

[11] *See* Interpretive Letter No. 331, April 4, 1985, *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,501.

[12] *See* Interpretive Letter No. 368 (July 11, 1986), *reprinted in* [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,538 (national

surance, and debt cancellation contracts, fixed annuity contracts are a specialized product, unrelated to the general life and casualty policies that section 92 concerns, that banks have authority to sell as agent.

Indeed, it is doubtful that the word "insurance" in section 92 can be construed to include annuities. Since the term is not defined in section 92, it should be given its common meaning.[13] Dictionary definitions of "insurance" invariably describe it as a contract for indemnification against risk of loss. For example, Black's Law Dictionary (1979) defines "insurance" as follows:

> A contract whereby, for a stipulated consideration, one party undertakes to compensate the other for loss on a specified subject by specified perils. . . . A contract whereby one undertakes to indemnify another against loss, damage, or liability arising from an unknown or contingent event and is applicable only to some contingency or act to occur in future. An agreement by which one party for a consideration promises to pay money or its equivalent or to do an act valuable to other party upon destruction, loss, or injury of something in which another party has an interest.

*See also Webster's Third International Dictio ry* (1971) ("coverage by contract whereby for a stipul.ted consideration one party undertakes to indemnify or guarantee another against loss by a specified contingency or peril"); *Random House Dictionary* (1973) ("coverage by contract

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bank may act as agent in the sale of title insurance incidental to authority to make loans secured by real property), Interpretive Letter No. 377 (February 6, 1987), *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 85,601 (operating subsidiary of national bank may underwrite title insurance for its mortgage loan customers); 12 C.F.R. § 7.7495 (national banks may enter into debt cancellation contracts); 12 C.F.R. § 2.6 (national banks may also issue credit life insurance or sell credit life insurance as agent).

[13] *See* 2A Sutherland, *Statutory Construction* § 47.28 (4th ed. 1984).

in which one party agrees to indemnify or reimburse another for any loss that occurs under the terms of the contract"); *Oxford English Dictionary* (Compact ed. 1971) ("a contract by which the one party (usually a company or corporation) undertakes, in consideration of a payment (called a *premium*) proportioned to the nature of the risk contemplated, to secure the other against pecuniary loss, by payment of a sum of money in the event of destruction of or damage to property (as by disaster at sea, fire, or other accident), or the death or disablement of a person"); *Helvering v. Le Gierse*, 312 U.S. 531, 542 (1941) ("Historically and commonly, insurance involves risk-shifting and risk-distributing."). Most authorities hold that annuities are not insurance, because they do not incorporate the element of indemnification against risk.[14] Courts considering the status of annuities as "insurance" have held that annuities are not insurance for purposes of federal tax law[15], several state tax laws,[16] bankruptcy law,[17] and other laws.[18] Al-

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[14] *See generally* 1 J. Appleman, Insurance Law and Practice, § 84 (1981) ("annuity contracts must . . . be recognized as investments rather than as insurance").

[15] *See Helvering v. Le Gierse*, 312 U.S. 531, 542 (1941); *Keller v. Commissioner of Internal Revenue*, 312 U.S. 543 (1941) (Under federal tax law which excludes "amounts receivable as insurance" from decedent's gross estate for tax purposes, annuities are not treated as insurance.).

[16] *See Kernochan v. U.S.*, 29 F.Supp. 860 (Ct. Cl. 1939); *In re Sothern's Estate*, 257 A.D. 574, 14 N.Y.S.2d 1 (1939); *In re Rhodes' Estate*, 197 Misc. 232, 94 N.Y.S.2d 406 (N.Y. Surr. Ct. 1949) (Annuity contracts are not within New York tax law exemption, applicable to insurance payable to a designated beneficiary, from estate taxes.); *People v. Knapp*, 193 A.D. 413, 184 N.Y.S. 345 (1920); *Commonwealth v. Metropolitan Life Ins. Co.*, 254 Pa. 510, 98 A. 1072 (1916); *Daniel v. Life Ins. Co. of Virginia*, 102 S.W.2d 256, 260 (Tex. Civ. App. 1937); *State v. Ham*, 54 Wyo. 148, 88 P.2d 484 (1939) (Consideration paid for annuity con-

though annuities often share with insurance the need for actuarial calculations, they are primarily a vehicle for investment, not indemnification.

A few authorities have characterized annuities as "insurance." Most significantly, the cases construing the scope of section 3(a)(8) of the Securities Act of 1933, 15 U.S.C. § 77c(a)(8), (exempting annuity and insurance contracts from the registration requirements of the Securities Act of 1933)[19] occasionally speak of fixed annuities as being "insurance" rather than "securities."[20] The exemption expressly covers both annuity contracts and insurance contracts, but the cases discuss the issue in terms of the distinction between "insurance" and "securities."[21] The

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tracts is not subject to tax law which taxes all "premiums" paid for insurance, because annuities are not insurance.)

[17] *See In re Walsh,* 19 F.Supp. 567 (D. Minn. 1937) (Annuity policy owned by bankrupt was not within insurance exemption to Minnesota bankruptcy law and therefore trustee in bankruptcy was entitled to the cash surrender value of the policies.); *In Re Howerton,* 21 Bankr. 621, 623 (1982).

[18] See Carroll v. Equitable Life Assurance Co., 9 F.Supp. 223 (W.D. Mo. 1934) (Defendant, a mutual insurance company forbidden by law to issue insurance contracts except by a "mutual plan", was nonetheless authorized to sell annuity contracts without a mutual plan because annuity contracts are investments rather than insurance.); Succession of Rabouin, 201 La. 227, 9 So.2d 529 (1942) (Insurance is not considered part of the decedent's estate for purposes of the law of "forced heirship", but annuities are part of the estate because they are not insurance.).

[19] Section 3(a)(8) is quoted *supra,* n. 2.

[20] *See SEC v. Variable Annuity Life Ins. Co.,* 359 U.S. 65 (1959); *SEC v. United Benefit LIfe Ins. Co.,* 387 U.S. 202 (1966); *Otto v. Variable Life Ins. Co.,* 814 F.2d 1127 (1986).

[21] *See e.g., SEC v. Variable Life Ins. Co.,* 359 U.S. 65, 75 (1959) (Opinion of Brennan, J.) ("The point [of the exemption] must have been that there then was a form of 'investment' known as insurance (including 'annuity contracts') which did not present very squarely the sort of problems that the Securities Act and the Investment Company

cases disregard state cases defining insurance on the grounds that the extent to which annuity contracts are insurance under a federal statute is a federal question.[22] The principal issue in these cases is the degree of investment risk that an annuity may incorporate without becoming a security subject to the Securities Act registration requirements. Those annuities that are exempt are labelled "insurance" and those that are not are labelled "securities."

These cases should not be read as holding that fixed annuity contracts are insurance for purposes of federal banking law. First, the holdings in these cases only address the applicability or inapplicability of the annuity exemption in § 77c(a)(8) to a particular instrument. The courts' characterization of the annuities in question as "insurance" is, therefore, dicta. Second, the analysis used to distinguish "insurance" annuities from "security" annuities only makes sense in the context of the federal securities laws. The standard that has emerged in this area focuses almost entirely on investment purpose and investment risk, so that an annuity may qualify for the "insurance" exemption even if it is totally lacking in mortality risk.[23] This standard is clearly narrowly tailored to the specific purposes of the Securities Act of 1933 and is therefore not useful in construing the term "insurance" generally.

Even under the *Saxon* court's reading of section 92, therefore, section 92 does not affect the power of a na-

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Act were devised to deal with, and which were, in many details, subject to a form of state regulation of a sort which made the federal regulation even less relevant."); *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 210-211 (same); *Otto v. Variable Annuity Life Ins. Co.*, 814 F.2d 1127, 1141.

[22] *See SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. at 68-69.

[23] *See* SEC Rule 151, 17 C.F.R. § 230.151; SEC Securities Act Release No. 6645 (May 29, 1986), *reprinted in* [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,004.

tional bank to sell annuities as agent. Under the *Saxon* court's interpretation, section 92 only limits a national bank's power to sell general life and casualty insurance. This limitation does not apply to annuities because they are, like credit life insurance, a specialized product that banks have authority to sell as agent, and because, in any case, they are not insurance for purposes of section 92 since they lack the basic insurance characteristic of indemnification against risk.

### 3. *Supervisory Issues*

Sale of fixed annuities as agent is a logical complement to other financial services offered by the Bank, such as financial planning, investment counseling, and discount brokerage services. State banks are already offering this product to customers. This activity will provide a valuable additional source of income and activity will provide a valuable additional source of income and will help the Bank to compete effectively with other providers of financial services. Since the Bank will act only as agent, the Bank will not have a principal stake in annuity contracts and therefore will incur no interest rate or actuarial risks.

Customers will benefit from the increased range of products made available to them by the Bank. Brochures, forms, and the prospectus describing the Certificates clearly and conspicuously state that the Certificates are a product of the insurance company issuer. The risk that customers may confuse the Certificates with federally insured deposit accounts is, therefore, minimal. As an additional safeguard against such confusion, however, the Bank should expressly disclose in its own advertising and promotional materials, and the Bank's employees should disclose when describing the Certificates to customers, that the Certificates are not products of the Bank and are not FDIC insured. Moreover, the Bank should obtain from the customer before a sale is made a signed statement that the customer understands that (1) the annuity product is an

obligation of the issuing insurance company and not of the Bank, (2) the Bank is acting only as agent for the insurance company, and (3) the obligation is not FDIC insured.

Finally, the Bank should determine whether any state laws govern this activity, and to the extent that they do, should comply fully with them.

**Incentive Program**

The proposed incentive program is legally permissible. Twelve C.F.R. § 7.5000 provides that "(a) national bank may adopt any reasonable bonus or profit sharing plan designed to insure adequate remuneration of bank officers and employees." However, incentive pay programs must be undertaken with care. At the same time that such programs further legitimate interests of the Bank, they have the potential for creating unintended incentives for employees to engage in improper activities, such as illegal product tie-ins and unsound lending. *See* Interpretive Letter No. 86, from John G. Heimann, Comptroller of the Currency (April 3, 1979), *reprinted in* [1978-79 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,161 (providing discussion of concerns with one such program and some guidelines for addressing). Thus, in the design and implementation of such programs, banks must evaluate the potential for such unintended effects created by their proposed program's specific provisions and take special care to ensure that there are adequate policies and procedures to counter such potentialities. In this case, for instance, the Bank should have controls in place to ensure, at a minimum, that product tying is avoided and that all required disclosures are made by employees in the sale of the annuity product.

**Percentage Lease**

The OCC has conditioned banks' authority to lease on a percentage basis on their observance of the safeguards

enumerated in Interpretive Letter No. 274 (December 2, 1983), *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,438 (attached). If the requirements stated in that letter are met, then the percentage leasing arrangement will be permissible. For the foregoing reasons, I conclude that the activities proposed for the Bank are permissible under the National Bank Act. The Bank will be expected to comply with the requirements set forth above relating to disclosures in the Bank's promotional materials and employee representations and the receipt of a signed customer statement, and to the design and implementation of its incentive pay program and percentage lease arrangement.

Very truly yours,
/s/ Paul Allan Scott
Paul Allan Scott
Chief Counsel